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THE AMENDED STOCKHOLDER PROPOSAL RULE: A DECADE LATER

Thomas M. Clusserath*

Under the authority of its rule-making power under Section 14(a) of the Securities Exchange Act of 1934, the Securities and Exchange Commission (hereinafter referred to as SEC) has adopted a series of rules, designated the Proxy Rules, which govern the solicitation of proxies by any person in respect of any security registered under the Securities Exchange Act of 1934, as amended.¹ Of these proxy rules, the most controversial is Rule 14a-8 (set out in Appendix), the stockholder proposal rule. This Rule requires the management of a company which is soliciting proxies² for a meeting of stockholders to include a proper stockholder proposal in its proxy statement when certain conditions are met. Those advocates of the small shareholder movement in institutions of higher learning and in the public and private practice of law and business have cited this Rule as the true bulwark of shareholder democracy.³ They argue that for the small shareholder, Rule 14a-8 now presents the sole means for the current exercise of initiative by him as an individual shareholder.⁴

After a public hearing, the SEC in early 1954 amended Rule 14a-8. One amendment concerned the procedure required for a reasonable presentation to management by a stockholder of a proposal for inclusion in the proxy statement. The second amendment included a technical limitation on resubmissions of identical proposals year after year to the same company. Another amendment was concerned with the substance of a proposal, *i.e.*, whether the proposal contained proper subject matter for stockholder action. With respect to the procedural amendment, the amended Rule required a sixty- instead of thirty-day *prima facie* advance submission of a proposal to the management.

* Former attorney-adviser in the Division of Corporation Finance of the Securities and Exchange Commission for better than two years. During that time, he served also in the capacity of an assistant to one of the present members of the Commission.

1 It should be noted that Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. § 78n) has been amended, as of August 20, 1964, (78 Stat. 565) to apply to the solicitation of proxies by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise by any person in respect of any security registered on any national securities exchange or of any security of a company of a certain size with so many stockholders which is traded in the over-the-counter market. Also, it should be noted that the Regulation 14 proxy rules have been applied to the solicitation of any proxies regarding any security of a registered holding company, pursuant to Section 12(e) and Rule 61 under the Public Utility Holding Company Act of 1935 (15 U.S.C. §§ 79-79z-6) and to the solicitation of any proxies in respect of any security of which a registered investment company is the issuer, pursuant to Section 20(a) and Rule 20a-1 under the Investment Company Act of 1940 (15 U.S.C. §§80a-1 through 80a-52).

2 In a solicitation of proxies from stockholders by the management of a company, three items are usually furnished to each stockholder: a written *notice* of the meeting for which the proxies are solicited; a written *proxy statement* concerning the matters to be taken up at the meeting (see Rule 14a-3 and Schedule 14A); and a *proxy* to be filled in by the shareholder (see Rule 14a-4).

3 See Bayne, Caplin, Emerson and Latham, *Proxy Regulation and the Rule-Making Process: The 1954 Amendments*, 40 VA. L. REV. 387 (1954); Freeman, *An Estimate of the Practical Consequences of the Stockholder's Proposal Rule*, 34 U. DET. L.J. 549 (1957); Heller, *Stockholder Proposals*, 4 VA. L. WEEKLY DIGEST COMP. 72 (1952-1953).

4 Bayne, Caplin, Emerson and Latham, *supra* note 3, at 391.

Thus, the individual shareholder, for a particular shareholder meeting, had to submit his proposal at least sixty days in advance of the day corresponding to the first date on which management proxy-soliciting material was released to security holders in connection with the last annual meeting of security holders (Rule 14a-8(a)). The second amendment substituted for the prior 3 per cent resubmission figure a progression requiring that a proposal which draws 3 per cent of the total number of votes cast in regard thereto on its first submission has to receive 6 per cent on its second submission, and 10 per cent on all subsequent occasions in order to remain qualified for resubmission at the next shareholders' meeting. Those that fail to obtain a 3-6-10 per cent vote are banned from successive submission for three years, instead of one year, as had been the case prior to the 1954 amendment (Rule 14a-8(c)(4)). And the substantive amendment specifically provided that the former requirement that a proposal had to be a proper subject for action by security holders *under the laws of the issuer's domicile* was to be retained (Rule 14a-8(c)(1)), but it limited the proper subject test by providing that a proposal amounting to a recommendation or request with respect to the "conduct of the ordinary business operations" of the company could be omitted by the management (Rule 14a-8(c)(5)).

Advocates of the small shareholder movement saw in these three amendments some added responsibilities for the SEC as administrator of this Rule.

First, there is the present SEC's responsibility of not permitting through its interpretation, particularly of the limitation placed on the "proper subject" test and of the application of the 60-day prima facie advance submission requirement, provisions for management protection to deteriorate into instruments of shareholder suppression. A further responsibility the present Commission has undertaken is the responsibility periodically to review the experience under these amendments to determine whether the amendments — insofar as they provide mathematically higher percentages and longer time periods, and insofar as they do not directly admit flexible interpretation — are, in effect, resulting in less individual or representative shareholder participation in corporate affairs.⁵

They concluded that if either responsibility of the SEC in the administration of this Rule was not fulfilled, the ultimate result of the 1954 amendments would be shareholder suppression, and not merely management protection, and that such a result would require a further amendment of the Rule, or restoration of the rescinded provisions.⁶

Needless to say, Rule 14a-8 has not been amended in the decade since 1954, nor has the SEC disclosed much, through public releases, concerning the administration of this Rule. Thus, this article will attempt to document⁷ Commission and staff action in the past ten years under Rule 14a-8. Atten-

5 *Id.* at 430-31.

6 *Id.* at 431.

7 Due to the fact that some of the information to be presented in this article concerns arguments made by management and proponents which were not placed in public files at the SEC, it will be necessary to avoid citing the names of companies and stockholders, except in cases where their arguments have become a matter of public record. But this inability to cite names should not detract from the benefit to be gained from a discussion of the treatment by the Commission and the staff of varied subject matters in proposals, their informal decisions, and various internal procedures used by the SEC in making such informal decisions.

tion will be focused on the subject matter of proposals which management has opposed to determine whether the SEC (Commission or staff) has omitted such proposals either under the 8(c)(1) argument that the proposal is not a proper subject for action *under the laws of the issuer's domicile*, or under the 8(c)(5) argument that the proposal relates to management action with respect to the conduct of the ordinary business operations of the issuer. Attention will also be focused on how the SEC has used the sixty-day advance submission requirement to permit management to exclude stockholder proposals and on how the SEC has interpreted the technical 8(c)(4) proviso which permits management to omit "substantially the same proposal" if the 3-6-10 per cent votes are not obtained on resubmissions. In disclosing the SEC's administration of Rule 14a-8 in these three areas, the writer will attempt to evaluate the SEC's activity and to offer some constructive suggestions.

I. Pre-1954 History of Rule 14a-8

Under the early proxy regulations as adopted pursuant to Section 14(a) of the Securities Exchange Act of 1934, some *ad hoc* action of the SEC resulted in the genesis of the stockholder proposal rule. In the 1939 fiscal year, the SEC was faced with a company's proxy-soliciting material which contained no information concerning two amendments to the by-laws which were to be proposed at the coming meeting of the stockholders by an independent stockholder. The management of the company had been advised of the stockholder action before it prepared its soliciting material. The Commission took the view that, since the proposed amendments pertained to matters to which the stockholders might properly address themselves, since the management was advised of the proposed amendments prior to the time its proxy-soliciting material was prepared and sent to stockholders, and since the proxies were apparently to be used for purposes of a quorum supporting action upon the proposed amendments, the omission from the proxy-soliciting material of information concerning such amendments rendered misleading the statement of management to the effect that the proxies would be used only with respect to the election of directors and not with respect to any other matter. The SEC required the management to send to stockholders a further communication fully apprising them of the stockholder proposals and giving them an opportunity to revoke the proxies which they had given.⁸ As a result of further proposals by stockholders which the SEC felt compelled to make management include to prevent management's proxy statement from being misleading, the stockholder proposal rule (then known as Rule X-14A-7) was adopted on December 18, 1942, and became effective on January 15, 1943.⁹

Under Rule 14a-7, management had to include in its proxy statement a stockholder proposal intended to be presented for action at the meeting *if* the stockholder had given management reasonable notice *and if* the proposal was a "proper subject for action by the security holders." As to the first condition, "reasonable notice," the new Rule 14A-7 provided that "notice given more than thirty days in advance of a day corresponding to the date on which

⁸ 5 SEC ANN. REP. 62 (1939).

⁹ SEC Securities Act Release No. 3347, Dec. 18, 1942.

proxy-soliciting material was released to security holders in connection with the last annual meeting of security holders shall, prima facie, be deemed to be reasonable notice." In a public release in 1945, the SEC quoted approvingly from a letter of the Director of the Division of Corporation Finance, interpreting the phrase "proper subject for action by security holders" to mean:

[M]atters relating to the affairs of the company concerned as are proper subjects for stockholders' action under the laws of the state under which it is organized. It was not the intent of the Rule X-14A-7 to permit stockholders to obtain the consensus of other stockholders with respect to matters which are of a general political, social or economic nature. Other forums exist for the presentation of such views.¹⁰

In 1952, the Commission specified that proposals which were "for [the] purpose of promoting general economic, political, racial, religious, social or similar causes" could be *omitted*.¹¹

In 1947, the SEC announced the redesignation of Rule 14A-7 as Rule 14a-8, which designation it has retained until the present time.¹² In 1948, the Commission amended Rule 14a-8 to permit the omission of a stockholder proposal for three additional reasons: (1) if it clearly appeared that the proposal was submitted by the security holder primarily for the purpose of enforcing a personal claim or redressing a personal grievance against the issuer or its management; (2) if the security holder had failed at the last two annual meetings to present his proposal at the meeting after management had at his request included it in its proxy statement; and, (3) if substantially the same proposal had been presented at the last annual or special meeting and had failed to receive three per cent of the total number of votes cast.¹³

In 1953 a public hearing was held on proposed amendments to the stockholder proposal rule. On the three amendments to Rule 14a-8 adopted in early 1954, the Commission made the following noteworthy comments. They will be of interest in the subsequent examination and evaluation of the SEC's administration of these amendments.

The amended rule specifically provides that a security holder's proposal may be omitted from the management proxy material if it is one which, *under the laws of the issuer's domicile*, is not a proper subject for action by security holders. The amended rule thus specifically provides that state law is to be the standard of eligibility of a proposal under the rule. The Commission wishes to make it clear that it considers this standard consistent with the decision of the Court of Appeals in the case of *SEC v. Transamerica Corp.*, 163 F.2d 511 (3rd Cir. 1947). Under the provisions of the amended Rule X-14A-8(c)(5), management would also be permitted to omit from its proxy material *a proposal which is a recommendation or request with respect to the conduct of the ordinary business operations of the issuer*.

The rule places the *burden of proof upon the management to show that a particular shareholder's proposal is not a proper one for inclusion in management's proxy material*. Where management con-

10 SEC Securities Act Release No. 3638, Jan. 3, 1945.

11 SEC Securities Act Release No. 4775, Dec. 11, 1952.

12 SEC Securities Act Release No. 4037, Dec. 17, 1947.

13 SEC Securities Act Release No. 4185, Nov. 5, 1948.

tends that a proposal may be omitted because it is not proper under state law, it will be incumbent upon management to refer to the applicable statute or case law and furnish a supporting opinion of counsel. [Emphasis added.]¹⁴

II. SEC Administration of the Amended Portions of Rule 14a-8

Since it is the intent of this article to document, as far as possible, the action of the SEC regarding stockholder proposals since Rule 14a-8 was amended in 1954, some description of the nature of Commission action in this area is in order.

It should be noted that SEC action under Rule 14a-8 is not, except in a few rare cases,¹⁵ a formal administrative adjudicatory order within the meaning of the Administrative Procedure Act.¹⁶ Rather these decisions must be understood in their context as *informal* administrative determinations not directly subject to review by Courts of Appeals. To the outsider these decisions take the following form in letters: that the Division of Corporation Finance or the Commission itself will raise no objections if the management omits the stockholder proposal from its proxy material or that the Division or Commission finds no reason for the omission of the stockholder proposal by management from its proxy material.

The greater percentage of the decisions¹⁷ discussed hereunder have been made by the Division of Corporation Finance¹⁸ without Commission approval or Commission review. Those decided specifically by the Commission have been taken there by the Division upon request of the proponent or the management of the company involved or upon the motion of the Division itself where an issue is important enough for decision by the Commission.

This article is not concerned with the administration of Rule 14a-8 in situations where management has included a stockholder proposal in its proxy statement without any objection to such inclusion pursuant to paragraph (d) of Rule 14a-8.

A. *Proposal as Submitted is not, Under Law of Issuer's Domicile, Proper Subject for Action by Security Holders*

This basis for exclusion of stockholder proposals from management's proxy statement (14a-8(c)(1)) had its birth with the development of the stockholder

14 SEC Securities Act Release No. 4947, Jan. 6, 1945. For a full text of Rule 14a-8 (17 C. F. R. § 240.14a-8 (1964)), see the Appendix.

15 See three formal opinions of the SEC pursuant to Section 12(e) and Rule 62 under the Public Utility Holding Company Act of 1935: SEC Public Utility Holding Company Act Releases Nos. 13450, April 17, 1957; 13710, March 21, 1958; 13962, March 26, 1959.

16 The formal administrative decisions would involve some form of adjudication required by statute to be determined on the record after opportunity for an agency hearing. See Section 5 of the Administrative Procedure Act (5 U.S.C. § 1004 (1950)).

17 All footnote cites to these decisions will provide the following information: the deciding body which will be indicated by a Commission Minute (COM. MIN.), a Division memorandum (DIV. MEMO.), or a Division letter (DIV. LET.) cite; and the full date. For an understanding of the reason behind the omission in most instances of the names of companies involved, see *supra*, note 7.

18 Usually the decisions of the Division of Corporation Finance are found either in a memorandum to an assistant director or the chief counsel or in a subsequent letter of the Division to the issuer and/or the proponent. It should be noted, as hereinafter demonstrated, that the responsible authority (branch attorney, branch chief, assistant director or chief counsel) for many of these decisions by this Division has not clearly been determined.

proposal rule as a positive statement that management must include a proposal which is a proper subject for action by security holders. The most recurrent problems for the SEC under this provision appear to have been the interpretation of the proposals in the light of applicable state law. In 1954, in the release adopting this language, the Commission specifically noted that state law was to be the standard of eligibility¹⁹ and that it considered this consistent with the 1947 case of *SEC v. Transamerica Corporation*.²⁰

The Third Circuit faced such a state law question with respect to three proposals submitted by John Gilbert in the *Transamerica* case.²¹ Were they proper subjects under Delaware law for action by security holders? The Third Circuit found that all three proposals were proper and specifically held that a proposal that shareholders elect independent public auditors, whether considered as a proposed by-law amendment or just a mandate to the board of directors, may not be deemed to be peculiarly within the discretion of the directors, who by Delaware statute are entrusted with the management of the business. The Court noted that "a corporation is run for the benefit of its stockholders and not for that of its managers."²² Second, the Court, in the most important part of its decision, noted that where a proposed action (amendment of the by-laws of the corporation) is within the purview of stockholders under state law, a procedural by-law of the company, which required that notice of any proposed alteration or amendment of the by-laws be contained in the notice of the meeting and which was valid under state law, may not frustrate "corporate suffrage."²³ As to the last proposal, which required that a post-meeting report be sent to all stockholders, the Court required inclusion for the reason that there is "no logical basis for concluding that it is not a proper subject for action by security holders."²⁴

Prior to the 1954 rule change, the Commission, faced with state law that was and is meager in specifics with respect to proper subjects for stockholder action, ruled that:

[P]roposals purporting to direct the directors in the management of the business operations of the company are improper. So also are the proposals commanding the directors to initiate corporate procedures which they alone can initiate, or proposals which ignore the statutory role of directors and propose the direct adoption of the particular corporate procedure. However, proposals relating to matters in those areas which are confined to management exclusively under state law are held proper by the Commission, if they are

19 See Heller, *supra* note 3, at 74, speaking of the state law standard:

[T]his must necessarily be so since the stockholder, if his proposal is adopted, must rely for its validity and enforcement solely on the law of the state of incorporation. The Commission is given no power in Section 14 of the Securities Exchange Act of 1934 to prescribe or determine what is desirable for the internal government of corporations.

20 163 F.2d 511 (3d Cir. 1947).

21 The Commission had decided that the management should include the three Gilbert proposals. Management refused. The Commission sought an injunction in the United States District Court to force the inclusion of these proposals. The District Court found that management had to include only one proposal. The Third Circuit found that management must include all three proposals.

22 *SEC v. Transamerica Corp.*, 163 F.2d 511, 517 (3d Cir. 1947).

23 *Id.* at 518.

24 *Id.* at 517-18.

phrased merely as a request or recommendation that the board consider the advisability of the action or procedure proposed by the stockholders.²⁵

In nonauthoritative sources, such as law review articles and the Gilberts' Annual Reports,²⁶ it often appears that a good percentage of the proposals included, prior to 1954, when in the form of a request or recommendation (*i.e.*, advisory in nature, rather than mandatory) related to what the layman might classify as the "ordinary business operation" of the issuer. For example, in 1952, the Commission held that the management of AB had to include a proposal relating to the elimination of the company practice of reducing retired employees' pensions by one-half or any part of the benefits received by such retired employees under the Social Security Act, if in form a recommendation.²⁷ Now, proposals which relate to everyday business operations are specifically excluded, whether in the form of a directive or of a recommendation by Rule 14a-8(c)(5).²⁸ So one whole area of advisory proposals is no longer a proper subject for stockholder action under SEC law, if not under the applicable state law. But the following pages will demonstrate that the problem of whether a proposal, in whatever form, is a proper subject for action by security holders has generated, since 1954, some confusion and inconsistency in Commission and Division decisions.

1. *Proper Subjects Since 1954*

It is only intended to review some of the important landmark decisions in the broad range of proposals and in the forms that these proposals may take. A more detailed analysis will be made in II.A2 of state law and forms for proper proposals thereunder.

Proposals dealing with subjects not felt to be peculiarly within the discretion of the board of directors, notwithstanding the state's general corporation law, have been included. This reasoning had its genesis in the *Transamerica* case. In 1958, the Commission required management to include a mandatory proposal requiring a full audit of the company and a subsidiary by an independent accountant.²⁹ In 1962, the Commission, while adopting the Division's reasoning somewhat along the same lines as above, required the management of CC to include an advisory resolution requesting the board of directors to direct the Chairman not to impose any arbitrary time limit on statements by stockholders at the annual meeting.³⁰ This request was included despite a by-law of the company which vested the direction of the meeting in the Chairman.

²⁵ Heller, *supra* note 3, at 74-75.

²⁶ E.g., Caplin, *Shareholder Nominations of Directors: A Program for Fair Corporate Suffrage*, 39 VA. L. REV. 141 (1953); Gilbert and Gilbert, *ANNUAL REPORT OF STOCKHOLDER ACTIVITIES AT CORPORATION MEETINGS* (from 1940); Note, 57 YALE L.J. 874 (1948).

²⁷ AB, COM. MINUTES, Feb. 18 and 19, 1952.

²⁸ In 1954, the Commission permitted the management of AB to omit an advisory proposal for the elimination of the company practice of reducing retired employees' pensions by one-half or any part of the benefits received by such retired employees under the Social Security System, pursuant to Rule 14a-8(c)(5). AB, COM. MINUTES, Feb. 10, 12, 16 and 19, 1954, and March 3, 1954.

²⁹ COM. MINUTES, Feb. 18 and 24, 1958.

³⁰ CC, COM. MIN., Feb. 19, 1962.

Proposals which relate to matters not specifically prohibited by state law which seem closely connected with basic, minimum shareholder rights have been included under the reasoning in the *Transamerica* case that there is no logical basis for not finding these to be proper subjects. In 1957, in a rather important decision that will be fully discussed later, the Commission found that part of a *mandatory* proposal directing SS to give a security holder a complete list of stockholders was a proper subject.³¹ In 1959, the Commission approved the Division's reasoning that a proposal *requesting* that a company furnish to shareholders for every meeting a proxy statement and form of proxy complying with the requirements of the rules of the SEC was a proper subject for action by security holders, whether advisory or mandatory in form.³²

Where the subject matter of the proposal (such as the sale of assets and merger or the approval of an investment advisory contract for a mutual fund) under state or federal law must eventually be approved by the stockholders, the proposal has been held to be a proper subject for action by security holders.³³ This reasoning is identical to that in the *Transamerica* case. The Commission has relied not only on state statutes for indications of matters subject to stockholder approval, but on state case law also. In 1955, it required the management of AA to include a proposal requesting the board of directors to submit a charter amendment to the stockholders. The amendment prohibited the board and the officers from making agreements or contracts with any director or stockholder owning over 10% of the company's stock without first obtaining the approval of a majority of the stockholders.³⁴ The applicable New Jersey case law held that a transaction between a corporation and a director or a stockholder with substantial holdings was subject to stockholder approval.³⁵ But in 1964, the Commission did not require management to include a proposal directing the board of directors of a mutual fund to institute suit against the fund's investment adviser for certain mismanagement of its securities, even though Maryland case law required prior to a derivative action by stockholders that an effort be made to obtain action by the directors.³⁶

Certain subjects seem to have been viewed as proper subjects for action even though the stockholder may submit two or three proposals very similar in nature and which in effect are a form of harassment. In 1955, the Commission held that the management of AA must include two proposals demanding investigations of two different sales by the company of portfolio securities, if they were revised as a request or recommendation.³⁷ In 1961, the Commission went further and required management to include two mandatory proposals directing the directors and officers to retain special counsel for in-

31 SS. COM. MIN., March 22, 1957.

32 COM. MIN., Feb. 13, 1959.

33 In DIV. LET., March 23, 1954, the included proposal requested and petitioned the board of directors to secure an offer for the sale and/or merger of the company and to report to stockholders for their consideration and approval. In COM. MIN., Feb. 10, 1964, the included proposal directed that in the future the mutual fund shall not enter into an investment advisory contract except upon approval by shareholders as a result of submission to shareholders of bids and proposals from at least three investment advisory organizations.

34 AA, COM. MINUTES, March 31 and April 4, 1955.

35 See AA, DIV. MEMO. March 30, 1955.

36 See DIV. MEMO. of Feb. 7, 1964, and proxy statement of same company.

37 AA, COM. MINUTES, March 31 and April 4, 1955.

quiring into the propriety of two major contracts.³⁸ However, the Commission indicated that "its determination . . . was not to be taken as a policy determination by the Commission that any and all contracts or transactions outside of ordinary business of a corporation necessarily gave to stockholders the right to request an investigation thereof."³⁹

It should be noted that stockholder proposals with respect to such matters as stock option plans for officers, cumulative voting for the election of directors, and information about annual stockholder meetings generally receive favorable treatment from the Commission, even though management may have sound reasons for omitting. For example, an advisory resolution proposing restrictions to be placed in future stock option plans had to be included in the proxy statement, notwithstanding the fact that the company did not contemplate a new option plan in the near future.⁴⁰ A proposal directing the board of directors to take all necessary steps to provide for cumulative voting for election of directors was permitted to be included in a proxy statement if cast as an advisory proposal (recommending or requesting).⁴¹ In 1962, the Division required management to include a proposal requesting that the proxy statement be released to the financial press at the same time it was mailed to the stockholders.⁴²

No matter how proper a subject matter the approval or disapproval of corporate action is by security holders, the Commission will not permit a stockholder proposal submitted for a special meeting of stockholders called for such approval, if it imposes a condition to the exercise of the authority to be granted. In other words, the approval or disapproval may be a proper subject, but the approval or disapproval conditioned in the above circumstances by a stockholder proposal is not a proper subject. For a special meeting of stockholders in 1955, the Commission permitted management to omit a stockholder proposal consenting to a flood loan borrowing (for which the meeting was called) upon certain express conditions.⁴³ This view is somewhat similar to the rule that a proposal which in effect is a negation of a management proposal is not a proposal within the meaning of Rule 14a-8.⁴⁴

2. *General Types of State Corporation Law and Their Effects on Form of Proper Proposals*

As noted earlier, recurrent problems arise with respect to the interpretation of stockholder proposals under the applicable state law. Probably no area of state statutory law is less fruitful than this. The difficulty is that there have been few cases dealing with shareowner's rights or proper subjects for their attention.⁴⁵

38 COM. MINUTES, May 2 and 5, 1961.

39 See COM. MIN. of May 5, 1961.

40 COM. MIN., Jan. 17, 1959. See DIV. LET., Jan. 6, 1958.

41 COM. MINUTES, Feb. 24 and 27, 1961.

42 DIV. LET., March 22, 1962.

43 COM. MINUTES, Oct. 10 and 11, 1955.

44 E.g., DIV. MEMO., Jan. 7, 1955; COM. MIN., March 3, 1961; COM. MIN., March 7, 1961.

45 Caplin, *supra* note 26, at 147-48:

A word about state statutory developments during the past twenty years.

At this level we have witnessed a marked trend toward the overhauling and modernization of corporation statutes. However, the emphasis has

The Delaware Code, a typical state statute, provides that "the Business of every corporation organized under the provisions of this chapter shall be managed by a board of directors, except as hereinafter or in its certificate of incorporation otherwise provided."⁴⁶ In at least two instances, the Division has used or has sanctioned management's use of the following reasoning where such a statute is in effect: under such a statute, for the shareholders to act in this business area, the certificate of incorporation or by-laws must so provide or they must be amended to so provide; since they do not and since the proposal is not in the form of a proposed amendment to the certificate or by-laws, the proposal is not a proper subject for action by stockholders. In 1955, the Division, using this approach, permitted management to omit a mandatory proposal directing that all major decisions of management should be approved by the shareholders,⁴⁷ and, in 1960, permitted management to omit a proposal directing the board of directors to engage in a study of the benefits of diversification and to seek opportunities to acquire companies.⁴⁸ Certainly, the Division ignored the reasoning in the *Transamerica* case that notwithstanding such statutes, subjects not felt to be peculiarly within the discretion of the board may be submitted to stockholders in mandatory proposals without amending the certificate of incorporation. If they did not feel that this reasoning was appropriate for these particular subject matters (that major decisions of management be approved and that the board make a study of diversification), surely the Commission decision in the AA case in 1955, which required management to include two proposals for investigations of past contracts, if in the form of a request, should have guided the Division in the 1960 ruling. In 1957, the Division permitted management (a business trust) to omit a proposal requesting the trustees to secure the cancellation of a contract or not to renew it, because the proposal was not in the form of an amendment to the declaration of trust or by-laws under which the management of the business had been entrusted to the trustees.⁴⁹ This decision may have been sounder than the above ones because under business trust law, activities of all parties (trust, trustees and shareholders) must be specifically set out in the declaration or by-laws (by no means the case under general corporation law).

There are some activities which are specifically set out in the state statutes or in the by-laws, such as the declaration of dividends and stock options, as being in the discretion of the board of directors. The Commission, and especially the Division, have given various treatment to stockholder proposals relating to such matters. In 1957, the Division permitted management to omit a stockholder proposal *directing* that a stock option plan be terminated and that prior to reinstatement stockholder approval be acquired, because it would violate a

still been upon keeping pace with the growing demands of businessmen and promoters: in regard to providing flexibility for the corporate venture and in regard to clarifying some of the uncertainties of corporation finance. Little thought has been given to the individual investor; if anything, the state statutes adopted during this period have tended to curtail, rather than to expand, his rights.

46 8 DEL. CODE ANN. § 141(a) (1953).

47 DIV. LET., Oct. 4, 1955.

48 DIV. LET., Feb. 24, 1960.

49 DIV. LET., Feb. 26, 1957.

statute vesting in the board power to create stock plans.⁵⁰ It held that such a statute can be evaded only by a proposed amendment to the certificate or by-laws.⁵¹ Later in 1957, the Division held that a by-law provision entrusting the determination of appropriate amounts of working capital to the board of directors would make a proposal relating to use of working capital improper if it was in the form of a mandate or directive to the board of directors; but the Division held that a request or recommendation for board action would be proper.⁵²

As noted above, some state statutes specifically give the board of directors the power to declare dividends and usually the articles and by-laws do likewise. In 1955, the Division, following the above reasoning, permitted management to omit a mandatory proposal respecting future dividends, because such a proposal, imperative in nature, would violate state law, and the company's articles and by-laws which contained such provisions giving the power to declare dividends to the board of directors.⁵³ But in 1955, the Commission in a landmark decision did not follow the Division's reasoning with respect to advisory proposals (*i.e.*, a mandate may violate the law or the by-laws, but a request or recommendation will not and so is proper). The Commission unanimously held, with separate statements by each Commissioner, that management could omit a proposal recommending a special cash dividend.⁵⁴ The Chairman's paraphrased statement seems most noteworthy: This proposal, whether phrased as a request or as a mandate, is not proper in the light of state law, the company's charter and by-laws, accumulated jurisprudence and general corporate law to the effect that questions of declaring dividends come solely within the jurisdiction of corporate directors. It is also noteworthy here that the Commission did not decide this under Rule 14a-8 (c) (5) (*i.e.*, that the declaration of dividends is a matter relating to the ordinary business operations of the issuer), although management had made this argument.⁵⁵ Again in 1964, the Commission, in a split decision (2 to 2) permitted management to omit a precatory proposal recommending a cash dividend.⁵⁶ The Chairman and one other commissioner, voting for inclusion of the proposal, held in separate statements that under local New York law, recommendations by stockholders which are not binding upon management are nevertheless proper subjects for stockholder action; that in the amendment of Rule 14a-8 in 1954, it was recognized

50 DIV. LET., March 13, 1957. In DIV. LET., March 4, 1958, the Division permitted management to omit a proposal directing the directors to use excess cash to retire shares of the company, because it would violate a Delaware statute vesting control of accumulated funds in the hands of the directors.

51 *But cf.* DIV. LET., Feb. 2, 1962, where the Division required management to include the stockholder resolution, as revised, proposing the amendment of the by-laws to provide that certain sales of stock by the directors would make them ineligible for future services as directors of the company. New York law gave directors authority to select directors subject to certificate and by-law variations.

52 DIV. LETTERS, April 12 and 17, 1957.

53 DIV. LET., February 17, 1955.

54 COM. MIN., March 24, 1955. In DIV. LET. March 15, 1962, the Division permitted management to omit mandatory proposals relating to the extension of merchandise discount cards to the stockholders of the company because under Illinois law the declaring of dividends is a function of the board and this extension of discount cards was a declaration of dividends and not a proper subject for shareholder action.

55 See NN, DIV. MEMORANDA, 1958-60.

56 COM. MIN., February 28, 1964.

that proposals which would be considered improper as directives would be proper in precatory form under paragraph (c) (1) and could be excluded from management's proxy material only if they relate to the ordinary business operations of the issuer. One of the commissioners whose vote for management's omission of this proposal helped carry the day, for management took a position with respect to (c) (1) similar to the Chairman's argument in 1955 in the case discussed above: matters which under the laws of the state are reserved expressly to the board do not become proper subjects for action by stockholders by the mere rephrasing of the resolution as one of recommendation or advice.

Where state law, the charter or by-laws of the company require that the latter two be amended to permit the proposed action, the proponent is faced with two problems: what form of resolution is proper where the stockholders can amend the governing instrument, and what form of resolution is proper for action by security holders where they cannot amend the governing instrument. In the first situation, the Commission, in 1954, held that a resolution *directing* the board of directors to take the appropriate action was improper under the state law since the articles could only be amended by the stockholders, but it permitted the proponent to revise the proposal as a proposed amendment by the stockholders.⁵⁷ In 1962, the Commission further held that a resolution *requesting* the board to amend the by-laws was improper where the stockholders had this power, but it permitted the proponent to rephrase the resolution as a stockholders' amendment.⁵⁸ In other words, the proper form of resolution where the stockholders can amend and the amendment is required is a proposed amendment by the stockholders. Note that in each of these decisions, the proposal was phrased improperly, but the Commission permitted the proponent to revise. In 1955, the Division refused to permit the proponent to rephrase five proposals demanding action by the board which could only be done by amendment of the by-laws by the shareholders,⁵⁹ arguing that:

While in some cases the Commission has directed the staff to inform a stockholder whose proposals were not in proper technical form for inclusion in the proxy material of the necessary changes required, it would appear that recasting of the proposals so as to meet the requirements of Ohio law would require such extensive legal advice that it is not practical under the circumstances to make the appropriate suggestions.⁶⁰

In the situation referred to above, where the stockholder cannot amend the governing instrument and the amendment is necessary, the Commission held in 1954 that a mandatory resolution to the board of directors was improper, but if the proposal were revised as a recommendation to the board to carry out the particular action (which they could do by amending the by-laws), it should be included.⁶¹ Finally, in this area of discussion where state law or the gov-

57 COM. MIN., July 30, 1954. The original proposal instructed the board of directors to take appropriate action to amend the necessary instruments to provide that any nominee for a directorship must own at least 1% of the company's stock.

58 CC, COM. MIN., February 19, 1962.

59 DIV. LET., October 4, 1955.

60 See DIV. MEMO. of October 3, 1955.

61 BB, COM. MIN., March 2, 1954.

erning corporate instruments require an amendment of the same, a 1961 decision of the Commission did not permit a stockholder to revise a resolution directing that no officer or director of the company could hold any office with another company until the stockholder suits against such company were finally settled.⁶² One of the two major reasons was that for such a resolution to be proper, both the certificate of the company (which specifically provided that directors of the company could be directors in other corporations) and a by-law (which required a two-thirds vote by stockholders for removal of a director) would have to be amended.

The last major problem under general state laws arises where the action of stockholders under state law, whether it be a major activity like merger or dissolution or a simple amendment of the articles of incorporation, must be preceded by certain actions of the board of directors, or at least "initiated" by the board of directors (by a resolution passed by it declaring the action advisable and submitting it to stockholders). Since such activity, under the *Trans-america* reasoning, is within the reach of the stockholders under state law, necessary procedural actions which must precede stockholder approval or disapproval should not prevent the basic proposal from reaching the stockholders. So the question of major significance is what form of proposal is necessary, if action by the board of directors must precede stockholder action. In 1955, the Commission required the management of AA to include two *advisory* proposals *requesting* the board of directors to initiate activity towards liquidation and to initiate necessary steps towards amending the articles, both activities which had to precede stockholder action in the particular areas.⁶³ The Commission and the Division in subsequent decisions⁶⁴ seem to have held that a recommendation or request to the board to do the initial activity is proper. However, in 1959, the Division did not follow this rationale with respect to a proposal submitted to management requesting that the board of directors take such steps as were necessary to merge the company with another at the exchange ratio of one of its shares for three shares of the other company.⁶⁵ In its memorandum, the Division noted that, although under the Delaware Code two-thirds of the stockholders must approve a merger, in this case the proposal attempted to set the terms and conditions of the merger, an area of corporate management which is not a proper subject for action by the security holders. It interpreted the wording of the proposal to be mandatory upon the board, if it was passed, in view of the fact that it instructs the board "to take such steps" as may be needed to merge with a particular company on definite terms. This interpretation and holding is esoteric. Could not the Division have adopted the approach taken by the Commission in 1954 in the decision discussed below?

In 1954, the Commission, in requiring BB to include, if revised in the form of a request, a stockholder proposal to increase the number of directors,

62 COM. MIN., March 6, 1961.

63 AA, COM. MINUTES, March 31 and April 4, 1955. See *supra* notes 45-46, and corresponding text.

64 *E.g.*, DIV. LETTERS, September 2, 1959, and January 5, 1960; DIV. LET., March 8, 1961; and DIV. LET., March 12, 1962.

65 DIV. MEMO., February, 1959.

seems to have noted that this action required amendment of the by-laws, which either the board or the stockholders could do, but which the stockholders could not do without initial action by the board. Since the proposal in original form was mandatory, it was improper for action by security holders, whether from board amendment or stockholder amendment viewpoints. So the Commission permitted inclusion, if the proposal was recast as advisory as to the board amendment or as to board action necessary for stockholder amendment.⁶⁶ During the next few years, the Commission and Division failed to follow any consistent approach when a mandatory proposal was submitted which, to be binding, required initial action by the board before stockholder approval or disapproval. In 1955, the Division permitted management to omit the proposal without providing the proponent with an opportunity to rephrase it as a recommendation or request.⁶⁷ In 1956, the Commission followed the Division's 1955 approach,⁶⁸ while the Division required management to include a proposal to split the common stock on a two-for-one basis, if in the form of a request or recommendation.⁶⁹ Again in 1957, the Division reverted to its 1955 approach.⁷⁰ Two years later, the Commission, in a formal proceeding under Section 12(e) and Rule 62 of the Public Utility Holding Company Act, permitted management to omit a mandatory proposal to amend the articles, but the Commission noted that the proponent "has submitted, and management proposes to include in its solicitation material, a related proposal in the form of a resolution calling on the board of directors to adopt and submit to the stockholders an amendment to the articles to restore preemptive rights."⁷¹ Again in 1960, the Commission permitted management to omit the mandatory proposal without giving the proponent an opportunity to revise it.⁷²

3. *Particular State Laws Which May Outlaw Proposed Activity*

There are state laws which prohibit certain actions, whether by stockholders, board of directors or the corporation, and any resolution, whether in proper form or not, proposing activity contrary to them is futile. Such laws have been raised against certain stockholder proposals, but some have been overcome by the ingenuity of proponents in sidestepping the grasp of such laws.

The first type of proposal affected by state laws is that of the Wilma Soss type which provides for the use of secret ballots at stockholder meetings in electing directors and in voting on resolutions. State laws cited against such a proposal provided stockholders with the right to challenge the vote of another stockholder, laws giving stockholders the right to challenge an attempted vote of an excessive number of shares, laws perfecting rights of appraisal by dissenters, and laws giving stockholders the right to change votes at any time before the result of the balloting is announced. The argument was not that

66 BB, COM. MIN., March 2, 1954.

67 DIV. LET., March 7, 1955. It should be noted that the management included this proposal in the 1956 proxy statement with the following change: "[s]tockholders hereby request."

68 COM. MIN., April 2, 1956.

69 DIV. LET., April 20, 1956.

70 DIV. LET., February 18, 1957.

71 SEC Public Utility Holding Company Act Release No. 13962, March 26, 1959.

72 COM. MIN., April 27, 1960.

secret balloting was directly contradictory to these rights, but rather that it would affect the procedures for exercising the rights given under these laws.⁷³ In 1954 and 1956, the Commission permitted the management of NN to omit an advisory proposal requesting that such method of balloting be provided.⁷⁴ In 1960, the break came when the Commission held that the following proposal, submitted to UU, had eliminated the above legal objections and was a proper subject for action by security holders: that the board of directors take such steps as may be necessary to provide a secret ballot for stockholders for the election of directors and for resolutions appearing in the proxy statement *except in specific instances and under specific circumstances where this may be contrary to existing New Jersey law.*⁷⁵ In 1961, a similar resolution was presented to AB, but the last part provided "except when secret voting can be proven specifically contrary to existing State Corporation Law or General Corporation Law of New York."⁷⁶ The Commission required the management to include it after the proponent revised this last part of the proposal to read as the UU proposal.

The second type of proposal affected by state laws is one prohibiting the counting of proxies with respect to a resolution unless they are specifically marked "for" or "against." In 1957, the Commission required the management of SS to include such a resolution subject to certain revisions.⁷⁷ No serious contentions regarding state laws were raised by management. In 1959, however, the management of Union Electric Company contended that under a Missouri statute, the shareholder had a right to give his agent an unsolicited discretionary proxy to vote all matters presented at a meeting and that this resolution would contravene the statute. The Commission agreed.⁷⁸ In 1962, the management of XYZ argued that such a proposal would constitute an illegal restraint on the right of a stockholder to give his agent a proxy to vote at the meeting in contravention of state laws.⁷⁹ The Commission seems to have accepted the Division's view that the proxy rules do not themselves confer discretionary authority, except with respect to matters which the persons on whose behalf the solicitation was made were not aware that they would be presented at the meeting,⁸⁰ and that the proposal does not violate the right of the stockholder under the law to attend the meeting by proxy. But the Commission conditioned requiring inclusion of the proposal on a revision to make it clear that it referred only to *solicited proxies*. The revised resolution was held by the Commission not to have been properly revised and management was permitted to omit it.

Sometimes a state statute will provide the "exclusive remedy" for dissenting stockholders in cases of a sale, consolidation or merger by the company; the Division has held that a proposal, whether mandatory or advisory,

73 See AB, DIV. MEMO. of January 30, 1961.

74 NN, COM. MINUTES, March 22 and 26, 1954, and April 2, 1956.

75 UU, COM. MINUTES, March 1, 3 and 4, 1960.

76 AB, COM. MINUTES, January 31 and February 1, 1961.

77 SS, COM. MIN., March 22, 1957.

78 See *supra* note 71.

79 XYZ, COM. MINUTES, January 24 and February 2, 1962.

80 See *supra* note 8, and corresponding text.

proposing a remedy for the dissenters is a departure from the "exclusive remedy" and is improper.⁸¹

Recently, the Commission held that a proposed by-law amendment prohibiting the company from purchasing stock in any other corporation without first obtaining the consent of the shareholders was in conflict with the articles of incorporation which authorized the purchase of stock in another corporation, and, because of this inconsistency, was improper under state law which limited by-law provisions to such as are "not inconsistent with law or the articles."⁸²

The Commission, in formal administrative adjudications, determined that two proposals, one to amend the by-laws to accord to the father of a minor stockholder all rights incident to stock ownership which are accorded to stockholders who have reached their majority, and another to amend the by-laws to permit a minor to vote his stock by a power of attorney, were improper under Missouri law.⁸³ In a contemporary intermediate court decision between proponent and Union Electric Company, the Missouri court had held that a minor could not appoint an agent. This was the effect of both of these resolutions.

Where a resolution directs the board of directors to carry into effect immediately another proposal, included by management without objection, which proposal the Division concludes is not binding upon the management, the subject resolution may be omitted by management because it, as a direction to the board, would be a futile and useless act.⁸⁴ This reasoning of the Division in 1959 may appear, at first glance, to miss the point with respect to advisory resolutions, which because of the law are often not legally binding. But the first proposal, which in form was mandatory but in effect only advisory, was the important proposal submitted because it pointed up the desired idea of the proponent (amendment of the certificate to provide for cumulative voting). The second resolution was in the nature of a ministerial matter having reference to certain acts of filing and recording an amendment.

In 1958, the Commission permitted the omission of a proposal under two different provisions of Pennsylvania state law.⁸⁵ The proposal was to amend the articles to provide for no increase in the number of directors without the approval of a majority of the stockholders, either at an annual or special meeting. Under Pennsylvania law,⁸⁶ amendments could only be proposed by the board or by petition of holders of not less than ten per cent of shares entitled to vote thereon, and since this proposal did not come from the board or the petition of the required ten per cent, the Commission seems to have held that as a mandate it was improper. Also, under Pennsylvania law,⁸⁷ there are quorum requirements for a meeting, and since this proposal is in terms of a

81 DIV. LET., January 30, 1962.

82 COM. MIN., March 3, 1961.

83 SEC Public Utility Holding Company Act Releases Nos. 13450, April 17, 1957; 13710, March 21, 1958; and 13962, March 26, 1959.

84 DIV. LETTERS, February 27 and March 12, 1959.

85 PP, COM. MIN., March 31, 1958.

86 15 PA. STAT. ANN. § 2852-802 (1958).

87 15 PA. STAT. ANN. § 2852-503 (1958):

A shareholders' meeting duly called shall not be organized for the transaction of business unless a quorum is present . . . (1) The presence, in person or by proxy, of the holders of a majority of the outstanding shares entitled to vote shall constitute a quorum.

majority vote of the shareholders, and not in terms of the vote of the shareholdings required for a quorum, it was held by the Commission to be in conflict with the quorum requirements of the law. Again we see an example of difficult logic, especially with respect to the second reason for permitting management to omit this proposal. Both objections could easily have been obviated by a proper revision.⁸⁸

4. *Propriety of Proposal Apart from State Law*

Many a proposal has been found to be improper for action by a security holder, not because there is a specific or general law under which it would be improper, but because of the subject matter or the circumstances under which it was submitted. For example, the Division has consistently permitted management to omit stockholder proposals relating to the size and speed of products produced by them.⁸⁹ They are rejected as violative of paragraphs (c) (1) and (c) (5). A proper subject, according to the Division, is a matter involving the conduct and management of the affairs and business of the corporation which is of significant interest to stockholders, but which does not relate to its ordinary business operations.⁹⁰ One cannot question the assumption that these proposals relate to the ordinary business operations of these two firms (the size and speed of their products), but to infer that because of this they are not of significant interest to stockholders and therefore not proper subjects for action by stockholders is questionable. Of course, because such proposals do relate to ordinary business operations, they should be excluded under (c) (5).

Sometimes a proposal may be a proper subject, but because the proposed action is already being performed or is intended to be performed, the Commission will not require management to include the proposal.⁹¹ Likewise, a proposal requesting that specific stock options be amended was omitted with the Division's sanction because these options were binding contracts between the corporation and the optionees which could not be changed unilaterally by the corporation.⁹² Also, the Commission has held that where a proposal, otherwise proper, contained references to the SEC or is premised upon the Commission's appointing a committee of investigators, it is improper to the extent of these references.⁹³ The Commission cannot appoint privately-financed investigating committees or approve or disapprove of such investigations. A proposal *directing* that additional information be forthcoming from the auditors in the annual report was omitted with Division sanction because, while auditors can be directed to give some information, that part of the proposal requiring auditors to state that payments

88 See PP, DIV. MEMO. of March 31, 1958.

Were . . . (this) proposal to provide for a vote by shareholdings and otherwise be amenable to state law, this Division would raise no objection.

89 *E.g.*, DIV. LETTERS, March 22, 1955, and March 19, 1958; DIV. LET., May 1, 1958.

90 See DIV. MEMO. of March 11, 1955.

91 In COM. MIN., February 13, 1959, the Commission required the management to include a proposal requesting the board to furnish the shareholders certain information unless it appeared from the company's preliminary proxy material that the full information called for had been provided. In DIV. LET., March 23, 1960, and DIV. LET., May 26, 1961, the Division permitted management to omit the submitted proposals because the question was moot or because of management's representation as to its intentions.

92 DIV. LET., December 5, 1956.

93 SS, COM. MIN., March 22, 1957.

by the company to "nonexistent" employees were bona fide was held to be beyond the scope of an auditor's functions. Because of this, the whole proposal was held to be improper.⁹⁴ It is questionable that the first part of the information demanded was so closely related to the last part that the whole proposal should fail.

The Commission and the Division have also omitted proposals which involved matters held not to be proper for shareholder action. In 1956, the Division sanctioned the omission of a proposal which had been made at the previous annual meeting of stockholders and which requested that a proxy statement include a list of all nominees for directorships because such a list was not proper matter to be included in a proxy statement for a subsequent annual meeting.⁹⁵ The Commission in 1961 sanctioned the omission by management of a proposal requesting that the stockholders be given the right to vote the stock AB owned in a subsidiary, because the proposal involved a matter which was the prerogative of management.⁹⁶ The next year, the Commission permitted management to omit a proposal requesting that no payments be made to brokerage houses for solicitation of proxies from accounts held in street names under certain conditions.⁹⁷ One of the two reasons for the action was that this matter, as recognized by Rule 14a-2(b)(2), is the business of the exchanges.⁹⁸

5. *General Remarks About Rulings on Form of Proposals*

As noted in the above cases analyzed in the discussion of proposed stockholder actions under II.A.2, the form of the proposal (*i.e.*, whether advisory or mandatory) is controlling as to whether a proposal is a proper subject, under the laws of the issuer's domicile, for action by security holders. While in many instances the Commission and the Division have permitted proponents to revise proposals into proper forms, this action has not been consistent. Here it is hoped to take one last look at what might be called some landmark cases in which both the Division and the Commission addressed themselves to the propriety of the proposal's form.

First, the Commission has permitted management to omit stockholder proposals because important parts are not definite enough to be proper subject matter for action by security holders. Secret balloting at stockholder meetings was rejected by the Commission on this basis (as well as the law basis discussed earlier).⁹⁹ The Commission found the following part of the proposal "not definite enough": the shareowners request our board of directors to take such steps as may be necessary to amend company's articles or by-laws to provide that in the election of directors and with respect to each resolution to be voted upon, shareowners can vote in private by secret ballot instead of voting by ballot open to the inspection of management and other persons, and such steps may include further study by impartial counsel as to ways and means to implement this (paraphrased to remove non-essential terms). In 1957, the Commission in

94 DIV. LET., October 4, 1955.

95 DIV. LET., February 24, 1956.

96 AB, COM. MINUTES, January 31 and February 1, 1961.

97 AB, COM. MIN., February 8, 1962.

98 The second reason for exclusion was 8(c)(5).

99 NN, COM. MIN., April 2, 1956. See *supra* note 74, and corresponding text.

formal administrative proceedings permitted Union Electric Company to omit a proposal directing the board of directors to set up a so-called office of stockholder relations headed by a "Stockholder Relations Officer."¹⁰⁰ The Commission gave as its sole grounds for the exclusion the fact that the proposal "as drafted and submitted to the company, is so vague and indefinite as to make it impossible for either the board of directors or the stockholders at large to comprehend precisely what the proposal would entail."¹⁰¹ And again in 1958, the Commission permitted the omission of a mandatory proposal submitted to PP because it was both vague and violative of (c)(5).¹⁰² However, the ruling of vagueness was not so well taken as in the two previous decisions. The proposal, evidently, was not deemed vague as a whole, but rather the important term "major holdings" was felt to be fundamentally indefinite. The proposal called for the amendment of the articles to provide for a majority vote of security holders before any sale or disposition of "major holdings."

Second, the Commission and the Division have permitted the proponent to correct vague and indefinite proposals as well as to remove parts of proposals which are improper under applicable state law. The landmark case is the SS decision in 1957.¹⁰³ The proposals submitted covered such things as investigating, voting only specifically-marked proxies, and furnishing the proponent a list of stockholders.¹⁰⁴ Each of these proposals was eventually included after revision to remove such defects as improper references to the SEC and improper procedure for counting of proxies under Michigan law. The Commission Minute instructed the Division to advise the proponent and the company that:

[N]o objection would be made to the omission of the proponent's resolutions, as submitted, from the management's proxy statement for the reason that specified proposals therein are improper, but that the proponent be afforded an opportunity to recast the resolutions so as to exclude the improper and that, if this is done by a specified date, the management should be required to include the revised resolutions in the proxy statement.

It was understood that the Division would follow this policy in its future administration of Rule X-14A-8(c), subject to the exercise of proper administrative discretion to maintain flexibility in the administration of the rule.¹⁰⁵

To judge the effect of this specific admonition to secure to the proponent the chance of correcting the form which renders improper his proposal, one can only view it in relation to other situations where the Commission and the Division have not given the proponent this opportunity. In the Union Electric Company and PP decisions, the proposals were short and vague, and the changes needed could not have been made by removal, but only by addition which might require a near impossible simulation of the proponent's

100 SEC Public Utility Holding Company Act Release No. 13450, April 17, 1957.

101 *Id.* at 8.

102 PP, COM. MIN., March 31, 1958.

103 SS, COM. MIN., March 22, 1957.

104 See *supra* note 31, and corresponding text.

105 E.g., COM. MINUTES, May 2 and 5, 1961; DIV. LET., February 1, 1962 (see *supra* note 51); DIV. LET., February 16, 1962 (see *supra* note 64); and CC, COM. MIN., February 19, 1962.

intentions. In the three proposals in this SS decision, all were verbose and detailed, and the changes required deletion, not addition.¹⁰⁶ One further word might be added to show when "administrative discretion" might be used to refuse a proponent an opportunity to revise his resolution, even though the form of the proposal could easily be corrected by revision rather than addition. Ten years ago the Division had a proponent with four proposals badly in need of revision, although some of them were possibly proper subjects for action by security holders. It permitted the management to omit all.¹⁰⁷

We have contended in past cases that if a proposal is unsuitable for inclusion in proxy material because so poorly constructed that stockholders would not understand what they were being asked to vote upon, the proponent should be so advised and invited to recast his proposal. This is not recommended in this case. The Division has had considerable correspondence from and with the proponent. We have tried to answer his inquiries to the extent of our knowledge, the information we have in our files, and our understanding of his rather confused requests, but he has been dissatisfied and quarrelsome. It does not appear from our knowledge that efforts to assist him in drawing up proper proposals would produce any useful result.¹⁰⁸

6. *Burden of Proof*

When Rule 14a-8 was last revised in 1954, the Commission specifically noted that subsection (d):

places the burden of proof upon the management to show that a particular shareholder's proposal is not a proper one for inclusion in management's proxy material. Where management contends that a proposal may be omitted because it is not proper under state law, it will be incumbent upon management to refer to the applicable statute or case law and furnish a supporting opinion of counsel.¹⁰⁹

As will be seen below, where this required burden has not been met in some cases, the Commission has acted to require inclusion of the proposal. But there are some questions about the Division's proper enforcement of this burden. In a speech given to the Society of Corporate Secretaries in June, 1960, the former Chairman of the SEC, Edward N. Gadsby said:

[I]n most of these cases (claiming the proposal to be illegal under state law) we are amply supplied with opinions as to the propriety

106 In AB, COM. MIN., February 26, 1964, the Commission affirmed the Division's position that management might omit the stockholder proposals, but the staff was instructed to explain to the stockholder that his major purpose of getting the management to develop a stock purchase plan was not objectionable, but that the form of his proposal (vague, indefinite and not reasonably subject to suggestions) was. Note that the Commission Minutes did not disclose that such instruction was given to the staff.

107 DIV. LET., March 17, 1954. The four proposals read: (1) That in view of the reduction of earnings and losses sustained, since 1948, that the salaries of the president, and other executives be reduced, as unreasonable, excessive and out of proportion to their services and the results in earnings to the corporation; (2) That Mr. . . . and Mrs. . . . return to the company common stock and stock dividends received by them, and for which they have not paid with their own funds, and not by way of dividends; (3) That stockholders be specifically notified that they have the right of cumulative voting, and should elect directors who can better manage the corporation; and (4) That the stock issued to Mr. . . . and Mrs. . . . was not registered with the SEC pursuant to the 1933 Act.

108 See DIV. MEMO. of March 10, 1954.

109 SEC Securities Exchange Act Release No. 4947, January 6, 1954.

or impropriety of the particular stockholder request, but, more frequently than not, counsel is unable to furnish us with a citation to controlling authority . . . the administration of this aspect of our proxy rules would quickly fall into hopeless confusion if we relied solely upon the arguments and opinions of counsel. We have found that, in most instances, it is necessary for the Commission to make an independent analysis of the proposal and of its probable legal effect under the appropriate state laws.¹¹⁰

It cannot be doubted that the Division does make an independent analysis of the state laws, but in few of the many memoranda that come from the Division to the Commission or from the branch attorney to the assistant directors or the Chief Counsel of the Division is this question of "burden of proof" treated. It was sometimes found that the burden of proof of management could not reasonably be considered to have been sustained with respect to the impropriety of the proposal. In 1955, the Division permitted management to omit a rather unusual proposal relating to the dismissal of the chairman of the board.¹¹¹ Management argued that the proposal could be omitted because it applied to the election to office, because the by-laws made provision for the election of the chairman, and, because according to an opinion of counsel under the laws of New York, the proposal was not a proper subject for action by stockholders. This opinion of counsel was a short one-paragraph letter which did not cite one authority. Yet the Division memorandum and letter to the company seem to indicate that management may omit the proposal because of the above reasons.¹¹² The Division should not have sanctioned the omission under (c)(1) because management, through a meaningless opinion of counsel, had failed to accomplish the first requirements of its burden of proof, *i.e.*, "refer to the applicable statute or case law."¹¹³

In 1959 and 1960, the Commission in landmark decisions required management to include proposals which were vigorously attacked by companies' counsel as improper under state law. One resolution submitted to management directed amendment of that company's by-laws to authorize cumulative voting, but counsel contended that the certificate of incorporation did not permit cumulative voting and that any amendment of the by-laws would be of no legal effect. However, after extensive research, the Division found that Maine law provided that the by-laws shall govern as to methods of voting, and that the attorney general of Maine had recognized that a certificate provision on this subject had no legal effect. In its letter to the company stating the Commission's decision, the Division noted that management had not met its burden of proof and that because of this and the view that doubts in regard to the propriety of shareholder proposals should be resolved in favor of their inclusion, management could not properly omit the proposal.¹¹⁴ In the Commission's decision in 1960 requiring UU to include the secret ballot proposal, the General Counsel's memorandum to the Com-

¹¹⁰ 191 COM. AND FINANCIAL CHRONICLE 1825 (1960).

¹¹¹ DIV. LET., August 9, 1955.

¹¹² See DIV. MEMO. of August 8, 1955.

¹¹³ *E.g.*, DIV. LET., January 17, 1955; DIV. LET., April 20, 1956.

¹¹⁴ COM. MIN., March 30, 1959; see DIV. MEMO. of March 27, 1959, and LET. of March 31, 1959.

mission, which seems to have influenced the decision most, noted that management had not successfully carried its burden of proof. This memorandum specifically defined this burden in the context of Rule 14a-8(d) to be a showing that the stockholder "resolution is clearly seeking something in the nature of a nullity."¹¹⁵

B. Proposal Relates to Conduct of Ordinary Business Operations of Issuer

In the discussion above under II.A, it was noted that many of the proposals prior to 1954 relating to business matters which under governing law were under the management of the board of directors were included in the proxy material of management if in the form of a recommendation or request and that many of these same proposals, in the layman's language, were concerned with the "ordinary business operations" of the company. In the 1954 amendment to the proxy rules, these proposals were considerably affected by a new Rule 14a-8(c)(5) which permitted management's omission of a proposal "if the proposal consists of a recommendation or request that the management take action with respect to a matter relating to the conduct of the ordinary business operations of the issuer."

In 1954, soon after the adoption of this amendment to the proxy rules, the Commission had occasion to discuss 8(c)(5) when a union presented the following proposal to AB: that stockholders *recommend* for the consideration of the board of directors the elimination of the company practice of reducing retired employees' pensions by one-half or any part of the benefits received by such retired employees under the Social Security Act. The Commission held that management could omit the proposal under new paragraph (c)(5).¹¹⁶ Each Commissioner had a comment, and there was one dissent. Two, in particular, held that since such plans under federal and state law were the subject of collective bargaining, their character seemed to be within the realm of wages, a subject which was under state law exclusively committed to the board of directors and therefore within the realm of ordinary business operation. This reasoning, and that of others in the majority, could be stated in the following manner: a proposal relating to a subject exclusively within the board of directors' activities under state law relates to "ordinary business operations" within the meaning of (c)(5). By "exclusively within the board of directors' activities under state law," the Commission does not seem to have made reference to a statute specifically stating that wages are within the control of the board, but evidently was referring to the broad state statutes which provide that the business of the company shall be managed by the board of directors. If this is what they meant, their reasoning is not sound, since those broad state statutes permit restrictions on this authority by the certificate of incorporation and include activities which no one using common sense can call "ordinary business operations." The Commission approved similar reasoning of the Division with respect to another proposal relating to wages of executives submitted in 1959.¹¹⁷ That proposal *requested* the board to make two changes in a stock option plan. The Division noted that stockholder action was neither

¹¹⁵ See *supra* note 75, and corresponding text, and see UU, General Counsel's MEMO. of March 4, 1960.

¹¹⁶ AB, COM. MINUTES, February 10, 12, 16 and 19, and March 3, 1954.

¹¹⁷ COM. MIN., March 13, 1959.

initially sought nor required and that it was nothing but an aspect of executive compensation entrusted by Pennsylvania law to the board of directors and thus excludable under 8 (c)(5).¹¹⁸ It is doubtful that this classifying of amendments to *stock option plans* as relating to ordinary business operations is valid.

While discussing this logically unpersuasive reasoning, one should note the Commission's decision with respect to a proposal submitted to PP in 1958.¹¹⁹ The proposal, which was a mandatory amendment of the articles to require approval of security holders for any sale or disposition of "major holdings," was omitted because it was too vague to be a proper subject for action by security holders¹²⁰ and encroached upon actions which are exclusively the prerogative of management and thus within the purview of (c)(5). The Division's memorandum to the Commission did not disclose any specific statute giving power with respect to this subject exclusively to the management, so again the Division must have made reference to the general type of state statute referred to in the preceding paragraph. But notwithstanding the basis of the statement that the subject was exclusively within the prerogative of management, such a subject still does not necessarily relate to "ordinary business operations."¹²¹

However, an observation is necessary with respect to the subject matter which is considered to be within the area of "ordinary business operations" under the reasoning of the 1954 AB decision. Excluding the questionable logic, it cannot be doubted that the Commission has determined in many cases that proposals whose subject matter involved compensation of executives (excluding directors) and employees in such forms as restrictions on wages, stock option plans and pension plans relate to matters concerning the conduct of ordinary business operations.¹²² But notwithstanding such Division and Commission determinations, management has included similar proposals without objection. These are not discussed in this paper.¹²³

In 1955, the Commission went a step further in its interpretation of 8(c)(5) in approving the Division's recommendation with respect to a proposal submitted to AA.¹²⁴ It held that even though the proposal was a proper subject for action by security holders under New Jersey laws and also within the power of stockholders as a proposed amendment to the articles of incorporation, it was excludable under 8(c)(5) because it was concerned with the ordinary busi-

118 See DIV. MEMO. of March 11, 1959.

119 PP, COM. MIN., March 31, 1958.

120 See *supra* note 85, and corresponding text.

121 See PP, DIV. MEMO. of March 31, 1958.

122 E.g., DIV. LETTERS AND MEMORANDA, February 14, 1955, February 24, 1956, February 13, 1958, February 17, 1959, and COM. MIN., March 17, 1961. The three types of proposals involved in these series of decisions were: to amend the pension plan so that it becomes a portable pension for aging employees who are left out before they become eligible for pension, or to change it from a non-contributory to a contributory plan; to resubmit the entire pension plan to stockholders for reconsideration; and to provide pensions for an employee discharged due to liquidation of a plant. But see COM. MINUTES, March 15 and 21, 1960, where the Division recommended that a proposal requesting the board of directors to reduce compensation of executives whose aggregate compensation exceeded \$50,000 until a cash dividend was paid be included because the effect of the proposal was to limit compensation of two directors only, so that proposal was not within 8(c)(5). Note that the company decided to include this before the Commission's decision.

123 See 22 SEC ANNUAL REPORT 103-4 (1956) and similar data in subsequent reports.

124 AA, COM. MINUTES, March 31 and April 4, 1955.

ness operations of the issuer. In this decision, the subject of the proposal was a request to amend the articles of incorporation to restrict the board in making any new investments in ships or shipping enterprise without first obtaining shareholder approval.¹²⁵ This holding has withstood attack until recently.¹²⁶ In 1961, the Division held:

[W]e are not prepared to conclude that a matter which the courts have held to be a proper subject for a shareholder's proposal to amend the by-laws is a matter relating to the conduct of the ordinary business operations of the issuer within the meaning of Rule 14a-8(c)(5) under the Securities Exchange Act of 1934.¹²⁷

The proposal directed reductions in salaries of all officers until a dividend was paid. Directors under the by-laws could fix the compensation of officers. But the shareholders could amend these by-laws under New York law. The Division, however, permitted management to exclude it unless the proposal was revised as an appropriate proposal to amend the by-laws.

Certain observations in the Division's memoranda concerning the meaning of the phrase "ordinary business operations" are worth noting. In 1954, the Division, in disregarding management's 8(c)(5) argument, stated that the phrase "ordinary business operations" was not necessarily synonymous with the phrase used by the company "within the usual and normal functions of the Board."¹²⁸ The proposal in this case, which management had to include, requested the board of directors to consider the advantages of a sale or merger. The Division noted that such a consideration might be within the usual functions of the board, but it did not relate to the ordinary business operations of the issuer. In 1960, the Division objected to the contention of the proponents that a policy of pricing the corporation's product was of such importance that it was not an "ordinary business operation."¹²⁹ In fact, the Division observed that the phrase "ordinary business operations" refers to the area or scope of activities and not to the significance or importance of such activities.¹³⁰

The Commission in 1955 held that a proposal *requesting* the board of directors of AA to make an *investigation* of a sale by the company of its holdings in a steamship company should be included in management's proxy material.¹³¹ The Commission approved the Division's memorandum which stated that, as to management's argument under 8(c)(5), an investigation per se is not within the ordinary business operations of the issuer.¹³²

C. Proposal Substantially the Same as Previously Submitted to Security Holders in Management's Proxy Statement for Stockholder Meetings Held Within Preceding Five Years and at Which it Received Less Than the Required Percentage of Total Votes Cast

125 In this same decision, a similar proposal to prohibit the Board and the company officers from making contracts or agreements with insiders pertaining to ships or shipping investments was held to be a proper subject for action by stockholders and not excludable under 8(c)(5).

126 E.g., DIV. LET., March 22, 1955; COM. MINUTES, February 18 and 24, 1958.

127 DIV. LET., January 19, 1961.

128 DIV. LET., March 23, 1954; see DIV. MEMO. of March 17, 1954.

129 DIV. LET., March 23, 1960.

130 See DIV. MEMO. of March 18, 1960.

131 AA, COM. MINUTES, March 31 and April 4, 1955.

132 See AA, DIV. MEMO. of March 30, 1954.

As discussed under I., this reason for omitting a stockholder proposal first appeared in the Rule in 1948. In 1954, with the last amendment to the Rule, this specific part was expanded and became paragraph (c)(4).

The most important part of this provision relates to the phrase "substantially the same proposal." In 1955, the Division held that a proposal requesting the board of directors to take the necessary steps to reduce the term of each director from five to two years was not substantially the same proposal as an earlier one which would have completely abolished the staggered system of electing classes of directors as well as having reduced the term of each director.¹³³ In other words, a proposal that does not go as far as another in the same area is not substantially the same. But in 1962, the Division permitted management to omit a proposal directing the board of directors to replace the present stock option plan.¹³⁴ It held the proposal to be substantially similar to another submitted to the stockholders the year before which would have abolished the present stock plan, because the proposed substitute plan would of course require suspension of the present stock option plan. It could be argued that this decision is inconsistent with that of 1955 since the proposal of an affirmative plan went further than the previous one.

The Division has rejected management's argument that a present proposal is substantially the same as a previous one because the purpose of both was identical.¹³⁵ The previous proposal had been with respect to cumulative voting; the later requested an increase in the number of directors. The Division noted in its memorandum that:

The phrase "substantially the same proposal" would appear to mean a proposal that is alike in scope and effect. The purpose for submitting a proposal does not appear to be material. There may be two means to accomplish the same objective but that would not necessarily constitute both means alike or the same. Furthermore, it is conceivable that stockholders may disapprove one means to accomplish a given objective and still approve another means to accomplish the same objective because the results are different.¹³⁶

The Commission approved the Division's recommendation in 1962 and rejected management's argument that a proposal submitted by a stockholder to abolish a stock option plan was the same proposal presented by management to stockholders in two previous years for the adoption of the same plan and that the favorable vote for the plan at those times was a defeat for the proponent's proposal.¹³⁷

A typical example of proposals which have been held by the Division to be substantially the same is a proposal in 1962 and 1963 to set a limit on individual executive compensation at \$200,000, and another in 1964 to set a limit of \$250,000.¹³⁸

133 DIV. LET., January 21, 1955.

134 DIV. LETTERS, February 6 and April 10, 1962.

135 DIV. LET., January 14, 1955.

136 See DIV. MEMO. of December 27, 1954.

137 XYZ, COM. MINUTES, January 24 and February 2, 1962. See *supra* note 79, and corresponding text.

138 DIV. MEMO., March 4, 1964. The argument was used even though the proponent in 1964 was not the same person or persons who submitted the proposal in 1962 and 1963.

In 1957 through 1959, the Commission, with respect to Union Electric Company's proxy statement, noted the contention put forth by Dyer, a stockholder proponent, that:

[M]any of the proxies voted against the proposals in prior years were invalid since they were "unmarked", that is to say, the forms of proxy contained boxes in which the signing stockholder might indicate by a check mark a vote for or against each proposal and no check mark was made in either box. Management voted the proxies against the proposals pursuant to the express authorization on the face of the form of proxy in boldface type if a choice for or against was not specified the proxy would be voted against the Dyer proposals . . .

But, continued the Commission:

Rule 14a-4(b) specifically permits such a proviso and we find nothing in the circumstances of this case to require a different result here. We must therefore reject Dyer's contention, as we have twice before rejected similar contentions by him.¹³⁹

D. Proponent Must Submit Proposal to Management a Reasonable Time Before Solicitation is Made

Rule 14a-8(a) sets up a test for determining whether a proposal has been submitted to management a reasonable time before the solicitation is made.

A proposal so submitted with respect to an annual meeting more than 60 days in advance of a day corresponding to the first date on which management proxy soliciting material was released to security holders in connection with the last annual meeting of security holders shall prima facie be deemed to have been submitted a reasonable time before the solicitation.

Prior to the 1954 amendment of the proxy Rule, the period had been thirty days.

Generally, the Commission and the Division have held that a submission *within* the sixty-day period is not prima facie unreasonable.¹⁴⁰ However, in 1956, the Division seems to have approved management's argument that a submission fifteen days prior to the mailing date for that year and eighteen days prior to the prior year's mailing date was not reasonable.¹⁴¹ The Division has permitted omission for late submission (sole reason) where the definitive proxy form has already gone to the press or is due to go.¹⁴² The Commission specifically permitted omission of a proposal submitted only fifteen days before the mailing date because of the hardship to management which might have resulted since, if the proposal would have been adopted, it might have caused some of the management's nominees to be disqualified.¹⁴³

139 SEC Public Utility Holding Company Act Release No. 13962, March 26, 1959.

140 *E.g.*, BB, COM. MIN., March 2, 1954 (Proposal was submitted 38 days prior to previous mailing date); DIV. LETTERS, March 7 and 24, and April 6, 1955 (Proposal was submitted 35 days prior to previous mailing date); DIV. LET., March 4, 1958 (Proposal was received by management 2 days after preliminary proxy material was sent to SEC); and see DIV. MEMO. of February 7, 1964 (Proposal was submitted 46 days prior to previous mailing date).

141 DIV. LET., January 13, 1956 (The proposal was omitted on other grounds also).

142 DIV. MEMO., December 6, 1961.

143 COM. MIN., March 21, 1961.

Where the proponent had known of a special meeting long enough to have presented a proposal sooner, the Commission held that the proposal was not timely submitted.¹⁴⁴ Likewise, the Commission has held that a submission by a stockholder within the sixty days was timely, though very late, when management had full knowledge of the subject matter of the proposal.¹⁴⁵

In 1960, management contended that a proposal directing that the company's stock be listed on the American Stock Exchange was not timely submitted because the proposal was not received by management twenty days before the preliminary proxy material was to be sent to the Commission. Management argued that under Rule 14a-8(d), management is supposed to file a statement for omission at least twenty days before preliminary material is filed, so the proposal must be received by the company more than twenty days prior to the proposed preliminary copies-filing date.¹⁴⁶ The Commission, in approving the recommendation of the Division, rejected this argument.¹⁴⁷

A stockholder presented a proposal requesting the board of directors to augment the board to the full number authorized under the by-laws, including at least one woman. Management objected that the proposal was to advance the special cause of the Federation of Women Shareholders in American Business, Inc., and therefore was excludable under Rule 14a-8(c)(2). The Commission accepted the argument of management in a two-to-one decision.¹⁴⁸ The proponent submitted a revised proposal, but the Commission again, by the same margin, permitted management to omit. In so voting, the Chairman and one other commissioner expressed the view that the proposal as revised:

although a proper one for inclusion in management's proxy material, was a different proposal from one originally submitted and that, since counsel for management had not had an opportunity to determine or argue his position on the merits, the Commission should not at this late date require the management to include the proposal in its material.¹⁴⁹

This second decision, if applied across the board could sustain the omission of any revised proposals submitted by stockholders.¹⁵⁰

III. An Evaluation of SEC Administration of Amended Portions of Rule 14a-8

A. 14a-8(c)(1) and 14a-8(c)(5)

Probably, the criticisms that can be directed to the SEC administration of these two substantive rules which exclude stockholder proposals that are not proper subjects for shareholder action under state law and those that relate to the ordinary business operations of the issuer can be categorized in the following manner: inconsistent administration, poor substantive law, and failure fully to inform outsiders of its informal decisions under these provisions.

144 COM. MINUTES, October 10 and 11, 1955. See *supra* note 43, and corresponding text.

145 E.g., COM. MINUTES, March 4 and 5, 1958; COM. MIN., January 6, 1959.

146 See DIV. MEMO. of October 5, 1960, and counsel's letter of September 27, 1960.

147 COM. MIN., September 30, 1960.

148 AB, COM. MINUTES, January 31 and February 1, 1961.

149 See AB, COM. MIN., of February 1, 1961.

150 See DIV. LET., of January 3, 1957.

1. *Inconsistent Administration*

In amending Rule 14a-8(c)(1) in 1954 to provide specifically that state law was to be the eligibility standard of a proposal under the Rule, the Commission noted that it wished "to make it clear that it considers this standard consistent with the decision of the Court of Appeals in the case of *SEC v. Transamerica Corporation*."¹⁵¹ Thus, the approaches of the Third Circuit to using state law in interpreting the propriety of stockholder proposals should have guided the SEC in its administration of 8(c)(1) since 1954. But such approaches have only partially been followed and then sometimes inconsistently.

For example, in the *Transamerica* case, the Court reasoned that a subject matter, such as the election of an independent public auditor, which was not felt to be peculiarly within the discretion of the board of directors could be submitted to a stockholder vote as a by-law amendment or as a mandate to the board, even though a state statute entrusted the management of the business to the board of directors.¹⁵² But the Division in 1955 and 1960 ignored such reasoning and excluded two proposals using the following contrary rationale: under such a general statute entrusting management to the board of directors, for the shareholders to act in this business area, the certificate or by-laws must so provide or be amended to so provide. Because the two proposals respectively, directed management to submit all major decisions to shareholders for their approval and to engage in a study of diversification, the Division permitted management to omit them.¹⁵³ First, this reasoning was not consistent with the *Transamerica* approach, which the 1954 amendment of 8(c)(1) was *not* to have changed. Secondly, if the Division did not feel that this reasoning applied to these particular subject matters, its refusal to permit the proponents to amend the proposals into precatory form was not consistent with a Commission decision in 1955 where management was required to include two proposals for investigations of past contracts, if *revised* in the form of a request to management.¹⁵⁴

A second example of inconsistent administration by the SEC of 8(c)(1) as amended occurs after its determination of the impropriety of the proposal. At that stage of its decision, it could do as the Division did in the two decisions discussed above, which was to permit management to omit the proposal without informing the stockholder of a possible revision of the form from mandatory to advisory or from mandatory or advisory to a proposed amendment of the articles of incorporation or by-laws of the company. Sometimes the Commission or Division refuses to give a stockholder the opportunity to revise the form of his proposal.¹⁵⁵ But in 1954 and 1955, the Commission set a precedent, consistent with its prior administration, of giving this opportunity to proponents.¹⁵⁶

Finally, there is a serious question as to whether the Division or the Com-

151 SEC Securities Exchange Act Release No. 4947, January 6, 1954.

152 See *supra* note 22, and corresponding text.

153 See *supra* notes 46-48, and corresponding text.

154 See *supra* note 37, and corresponding text.

155 See *supra* notes 66-72, and corresponding text.

156 See *supra* notes 37 and 66, and corresponding text.

mission has properly enforced the burden of proof placed upon an objecting management using the 8(c)(1) argument. As was disclosed above, this burden of proof on the part of the opinion of counsel for management, which is required by paragraph (d) of Rule 14a-8, as amended in 1954, requires as a starting point that the opinion cite statute or case law of the particular state to support the opinion. But the Division in some instances has ignored this very basic starting point.¹⁵⁷ One possible reason for such failure to enforce this legal requirement is that sometimes a branch chief or examiner who handles the material for the Chief Counsel's office is not an attorney and may fail to recognize or even know about the burden of proof requirement.¹⁵⁸

2. *Poor Substantive Law*

Certain decisions of the Commission itself have produced weak law. An example is the 1955 decision, reaffirmed in 1964 by a split Commission, that a proposal respecting the declaration of dividends is not a proper subject for shareholder action under SEC law, notwithstanding what the highest court of a state had said about subjects available for a non-binding shareholder vote.¹⁵⁹

3. *Failure Fully to Inform the Outsiders*

The Division's approach to informing proponents and management as to its or the Commission's decision in the particular case is not sufficiently precise in many cases. Usually, in situations where management is permitted to omit the proposal from its proxy material, the letter to the proponent and the management merely states the proposal, management's arguments, and the fact that management may omit the proposal.¹⁶⁰ If management must include the proposal, the letter often merely states the proposal and the fact that management must include the proposal.¹⁶¹ In those situations where the proponent is given the opportunity to revise the proposal, the letter may be more informative.

Certainly, the inconsistent use of certain basic precedents in the determination of the propriety or impropriety of a proposal may not have led to stockholder suppression in all instances, but in the case of a less well-informed and non-professional proponent (the professionals are given better treatment in some cases), the inconsistent treatment certainly is a handicap. For instance, the failure of the SEC to let a stockholder revise a proposal, when precedent would call for such action, may result, if the Division fails to disclose what is wrong with the form, in an inability to exercise the right properly.¹⁶² The narrow

¹⁵⁷ See *supra* notes 111-3, and corresponding text.

¹⁵⁸ *E.g.*, in COM. MIN., November 13, 1963, the Division had told the proponent that his proposal could be omitted under 8(c)(1), but the Commission overruled that reason and held that because the proposal was the opposite of management's proposal it should be omitted. This was in accordance with prior holdings of the Commission. No attorney from the staff was present at this Commission meeting. This situation was recorded by this writer who was present at these Commission meetings.

¹⁵⁹ See *supra* notes 54-56, and corresponding text.

¹⁶⁰ *E.g.*, DIV. LET., October 4, 1955; DIV. LET., January 31, 1956, and MEMO. of February 6, 1956; and DIV. MEMO. of February 13, 1958, and LET. of February 21, 1958.

¹⁶¹ *E.g.*, DIV. MEMO. of April 1, 1954, and LET. of April 22, 1954; and DIV. LET. of April 3, 1959.

¹⁶² *E.g.*, In AB, DIV. MEMO. of February 25, 1964, and COM. MIN. of February 26, 1964, the Commission affirmed the Division's position that the management might omit the

view consistently taken by the Commission with respect to the declaration of dividends is probably not good precedent, and it, like the other criticized administrative approaches under amended 8(c)(1) and 8(c)(5), could be said to have resulted in less individual or representative shareholder participation in corporate affairs.¹⁶³

B. 14a-8(c)(4) and 14a-8(a)

In disclosing in II.C and D above the SEC approach to technical limitations on resubmissions of substantially similar proposals and its approach to the prima facie reasonable time submission requirement, this author did not statistically attempt to show how often the Commission or Division sanctioned omission of proposals under these provisions. But a long and rather complete perusal of this area does not suggest that the SEC has permitted these stringencies of 1954 origin to affect substantively good proposals except where the resubmission or submission is in *literal* compliance with the reason for omission. For example, the rationale of the Commission in the last situation discussed above under II. D has not resulted in a rule of thumb which can be used to make meaningless stockholder revisions of the form of otherwise proper proposals.¹⁶⁴ Of course, the more onerous technical limitations on resubmissions which had their origin in 1954 may result in some proposals being omitted after successive submissions in which the proponent failed to receive the 3-6-10 per cent of votes cast, but the Division and Commission have not permitted management to stretch the requirement that the *proposal be substantially the same* to reach unrelated proposals.¹⁶⁵ Thus, it does not appear that the limitations in 8(c)(4) and the sixty-day prima facie submission requirement have become instruments of shareholder suppression.

IV. Proposals for Effective and Consistent Administration of Rule 14a-8

None of these proposals is for the amendment of Rule 14a-8. The rule is complicated enough, and with the Securities Act Amendments of 1964¹⁶⁶

stockholder proposal, but the Division was instructed to explain to the stockholder that his major purpose of getting management to develop a periodic stock purchase plan was not objectionable, but that the form of the proposal (vague, indefinite and not reasonably subject to suggestions) was. Whether the Division so informed the proponent is not known, but the Commission minutes do not disclose such advice to the staff (see *supra* note 106, and corresponding text). In COM. MIN., of November 13, 1963, the Division had told the proponent that his proposal could be omitted under 8(c)(1), but the Commission overruled that reason and held that because the proposal was the opposite of management's proposal it should be omitted. The Commission instructed the Division to indicate this reason to the proponent, but the Commission minutes did not record this instruction. The Division did not send a letter to the proponent; they did send a telegram which did not indicate any reason for the Commission's decision (see *supra* note 160, and corresponding text). The instructions of the Commission to the Division in these two cases were recorded by this writer who was present at these Commission meetings.

163 In the 1956 fiscal year, the management of twenty companies omitted from their statements, under Rule 14a-8, a total of forty-one stockholder proposals tendered by twenty-six individual stockholders. 22 SEC ANN. REP. 103-04 (1956). In the 1963 fiscal year, the management of twenty-six companies omitted from their proxy statements, under Rule 14a-8, a total of sixty-one proposals submitted by forty-five individual stockholders. 29 SEC ANN. REP. 54 (1963).

164 See *supra* note 66, and corresponding text.

165 See *supra* notes 135-37, and corresponding text.

166 See *supra* note 1.

expected to bring approximately 2,000 to 3,000 more issuers under the proxy rules and Rule 14a-8 in the next few years, a more complicated stockholder proposal Rule would only result in less shareholder use of the Rule.¹⁶⁷ Rather, it is suggested that the informal process of decision-making under this Rule be continued with three modifications or improvements to insure that the Rule is used more effectively by stockholders (especially the non-professionals) and managements of companies subject to it.

A. *Fully Inform the Outsider*

The stockholder who submits the proposal and the management which opposes its inclusion should always be accurately informed of the Commission or Division position. Often, management will throw the whole book of objections at a particular stockholder proposal, and later the staff's letter to both concerned parties will only inform them that the Division or Commission will raise no objections if management omits the stockholder proposal from its proxy material or that the Division or Commission finds no reason for the omission of the stockholder proposal by management from its proxy material.¹⁶⁸ Such general, uninformative statements are often of no aid to the stockholder concerned, and such refusal by the staff to indicate the grounds of the decision may frustrate the full achievement of the ultimate aim of the proxy provision, "true corporate democracy."¹⁶⁹

Consideration should also be given to issuing a periodic public release setting forth the type of stockholder proposals which the Commission has seen fit to include or exclude.¹⁷⁰ The Commission has developed a wealth of information as to matters which are of interest to stockholders, as demonstrated by the subject matter classification below. Further clarification by a public release of the permissible scope of proposals, under 8(c)(1), would also be a valuable guide to the courts as well as to corporate management in determining which proposals are required to be included in proxy statements.

B. *Better Supervision by a Top Staff Attorney*

Although some of this material dealing with contested Rule 14a-8 proposals is examined by the Chief Counsel of the Division of Corporation Finance, instances of non-attorneys actually determining state law questions under 8(c)(1), checking the legal opinions of management attorneys, and making policy decisions under 8(c)(5) have been noted.¹⁷¹ Such instances should be

167 Wall Street Journal, Sept. 15, 1964, p. 4, col. 4.

168 See *supra* notes 160-61, and corresponding text.

169 See *supra* note 162, and corresponding text.

170 TASK FORCE REPORT ON REGULATORY COMMISSIONS (Appendix N) 147-48 (1949):

The Commission [S.E.C.] gives adequate publicity to regulations, contested cases, and individual determinations of widespread interest. *But* the views of the Commission on many day-to-day problems are hidden away in deficiency letters, individual interpretations, and memoranda of private conferences. Many of these are compiled for internal use as precedents to guide the staff in its actions, either in a volume explaining the Securities Act and its administration, or in Memoranda of Administrative Practice, containing current rulings. While some of these rulings are published as press releases, the vast majority are not available to the public. [Emphasis added.]

171 See *supra* notes 111-13 and 158, and corresponding text.

prevented by the use of qualified and responsible attorneys given authority to pass on all Division activity under Rule 14a-8 and especially under 8(c)(1) and 8(c)(5), to attend all Commission meetings concerning contested proposals and to check all Division letters sent to proponents and management informing them of the Division or Commission decision.¹⁷²

C. *Improve Staff Interpretations under 8(c)(1) and 8(c)(5)*

It is important for the effective and consistent administration of Rule 14a-8, especially with respect to the non-professional stockholder, that staff attorneys be fully informed of certain rather significant precedents and long-run policy approaches of the Commission.¹⁷³ During the proxy season (February through May), adequate research cannot be performed by the staff attorney because of the volume of work. Thus, this approach can guarantee more consistency.

First, both the Commission¹⁷⁴ and the staff¹⁷⁵ have taken the long-run approach that a proponent may revise a vague and indefinite proposal or remove improper parts of an objectionable proposal under the applicable state law (8(c)(1)). Thus, the stockholder-proponent should always be furnished an opportunity within a reasonable time limit to correct such inadequacies.

Second, the staff should be made aware of certain basic tenets as to the proper form for many types of proposals under applicable state laws so that the proponent may be given the opportunity to correct inadequacies under 8(c)(1). Some of these tenets are:

1. Where management argues that because applicable state statute provides that the business shall be managed by the board of directors, the board has exclusive discretion unless the certificate or by-laws are amended with respect to the specific matter; a proper proposal in regard to the subject matter may take at least three forms: the form of a recommendation or request to the board of directors to take the necessary action (*i.e.*, an advisory resolution); a proposed by-law amendment, if the stockholders can amend the by-laws directly; and a proposed amendment of the certificate, if the stockholders can amend the certificate directly.¹⁷⁶

2. Where the state law requires that the charter or the by-laws be amended to permit the proposed action, the proponent is faced with two situations: the form of resolution that is proper where the stockholders *can* amend the governing instruments; and the form of resolution that is proper for action by security holders where the stockholders *cannot* amend the governing instruments. In the first situation, the proper form is a proposed amendment by the stockholders, not an advisory resolution.¹⁷⁷ In the second situation, the

172 See *supra* notes 106, 158 and 162, and corresponding text.

173 See *supra* notes 151-58, and corresponding text.

174 See *supra* notes 103-05, and corresponding text.

175 See MEMORANDUM of Director of Division of Corporation Finance to Staff, dated April 17, 1957, regarding "Stockholder Proposals Combining Objectionable Proposals with Proper Proposals."

176 See *supra* notes 46-49, and corresponding text.

177 CC. COM. MIN., February 19, 1962. See *supra* notes 57-60, and corresponding text.

proper form of resolution is a request or recommendation to the board to carry on the particular action which they could do by amending the by-laws.¹⁷⁸

3. As noted above, a mandatory proposal which directs or commands the board to do something which by state statute is in the discretion of the board or which must be initiated by the board often is improper unless in the form of an advisory proposal which requests or recommends that the board do the particular thing. The rationale for this difference in the form, upon which the propriety of the proposal depends, is basically legal. For example, a proposal which commands is capable of being legally binding upon the directors. If the proposal, because the action is in the discretion of the board, cannot be legally binding, it is misleading under Rule 14a-9¹⁷⁹ to give the impression that the proposal is binding; the advisory resolution, which merely requests or recommends that the board do something but does not bind it in any manner, is not misleading in such a situation.¹⁸⁰

Third, staff attorneys should be informed that the failure of management to carry its two phases in the burden of proving¹⁸¹ that the proposal is not a proper subject for action by security holders under the laws of the issuer's domicile will cause the inclusion of the proposal or the non-recognition of the particular argument (8(c)(1)) by the staff, notwithstanding an independent analysis of the state law and proposal by the staff. It is not the SEC's job to interpret state law except where management has carried this burden of proof.

Finally, the best way to develop an understanding by the staff of the meaning of proper subjects for shareholder action under 8(c)(1) and of "ordinary business operations" under 8(c)(5) would be to develop a classification of proposals by subject matter.

The following classification might be of some aid.

1. Accountability and Reporting to Stockholders by Management

a. Post-Meeting Reports

Generally, a resolution, whether *mandatory* or *advisory*, proposing that a report containing a digest of the activity at each annual stockholder meeting be sent to shareholders, is proper for action by security holders. These proposals are included, notwithstanding the form, because under the *Transamerica* decision there is no logical reason to omit them, since such reports are not part of the business of the company understood to be entrusted to the board by general state statutes.¹⁸²

178 BB, COM. MIN., March 2, 1954. See *supra* notes 61-62, and corresponding text.

179 Rule 14a-9 (17 CFR § 240.14a-9 (1964)) specifically provides that no solicitation subject to Regulation 14 shall be made by means of any material which under the circumstances is false or misleading.

180 See *supra* note 84, and corresponding text.

181 These two phases are: (1) when management contends that a proposal is improper under applicable state law, management must submit an opinion of counsel and must refer (i.e., cite) to the applicable statute or case law (See *supra* notes 111-13, and corresponding text). If management fails to do this, it seems that the burden of proof has *automatically* not been sustained; (2) after management has met the first requirement, its arguments under the applicable state law must show that the stockholder "resolution is clearly seeking something in the nature of a nullity." (See *supra* notes 114-15, and corresponding text.)

182 BB, COM. MIN., March 2, 1954.

b. *Periodic Reports*

Here, as with post-meeting reports, a resolution, whether mandatory or advisory, proposing that the board send monthly or quarterly financial reports to stockholders, is proper. Again, *Transamerica* permits inclusion, notwithstanding the form that is used. But proposals requesting that certain additional information be contained in the annual reports to stockholders may be *improper*, even if the supposedly proper form is used, for instance, where the additional information requested is subject to being withheld by the management with state court sanction¹⁸³ or where the additional information cannot properly be furnished by the auditor as directed.¹⁸⁴

c. *Proxy Statement*

Generally, stockholder proposals *requesting* additional disclosures in management's proxy statements are proper subjects for action by security holders.¹⁸⁵

2. *Stockholder Activities*

a. *Place and Frequency of Meetings*

Stockholder proposals requesting a specific date for annual meetings of stockholders¹⁸⁶ and requesting that meetings be held in particular places or, at least every so often, in a particular city¹⁸⁷ are proper subjects for action by security holders.

b. *Proxy Voting*

See the discussion above under II.A3.

3. *Stockholder Remuneration and Share Ownership*

a. *Dividends and Other Tangible Benefits*

Resolutions proposing the declaration or payment of cash or stock dividends or the rounding out of resulting fractional payments in stock dividends are improper for action by security holders.¹⁸⁸ No matter what form of proposal is used, this area has been held exclusively within the discretion of the board.

4. *Path or Destiny of Particular Corporate Organization*

a. *Public Auditors*

Proposals *directing* an independent audit of the financial affairs of a company or its subsidiary¹⁸⁹ and *directing* that the company's auditors attend the annual meeting and answer any questions submitted¹⁹⁰ are proper for action by security holders in accordance with the holding in *Transamerica*.¹⁹¹

b. *Major Acquisitions and Sales*

A majority of the resolutions in this area propose that major decisions,

183 COM. MIN., January 26, 1954.

184 DIV. LET., October 4, 1955.

185 E.g., DIV. LET., February 21, 1958; COM. MIN., February 13, 1959; DIV. LET., April 3, 1959; and DIV. MEMO., February 1, 1962, and DIV. LET., February 2, 1962.

186 COM. MIN., March 7, 1961.

187 CG, COM. MIN., February 19, 1962.

188 See *supra* notes 53-56, and corresponding text.

189 COM. MINUTES, February 18 and 24, 1958.

190 DIV. LETTERS, September 2, 1959, and January 1, 1960.

191 See *supra* notes 29-30, and corresponding text.

such as the acquisition or sale of properties shall not be made by the board of directors without the approval of a majority of shareholders. Many such proposals are held to be improper, not because the subject under state law is improper, *but because* the form is improper (*i.e.*, the proposal should have been in the form of an amendment or advisory or more definite).¹⁹² Sometimes such a proposal is in proper form, but it may be excluded because the purchases, subject to stockholder approval, are so inclusive as to relate to ordinary business operations.¹⁹³

c. *Liquidation, Merger or Sale*

Since most state statutes provide for shareholder action with respect to liquidation, merger or sale of the assets of a company, the major problem in the area concerns the proper form such a proposal must take. Mandatory proposals directing the board of directors to liquidate the company are usually improper, because under the applicable state law the action with respect to liquidation must originate with the board.¹⁹⁴ Usually advisory resolutions requesting the board to formulate a plan of liquidation are proper,¹⁹⁵ but advisory proposals requesting the merger and setting out some of the details thereof are improper, because they attempt to set out the terms of the proposed merger, which attempt is usually contrary to law.¹⁹⁶ However, such a proposal is proper if such action as to details is sanctioned by law for shareholder consideration.¹⁹⁷

A *mandatory* proposal directing, in the event of a merger, that certain financial statements be submitted to the stockholders comes within the *Transamerica* principle requiring a company to furnish its stockholders information and is therefore proper for action by security holders.¹⁹⁸

5. *Qualification, Selection and Remuneration of Directors and Officers*

It should be noted that some of the proposals in this area *may* be found to relate to the conduct of the ordinary business operations of the issuer if they refer only to the officers of the company.

a. *Qualifications*

The qualifications for a nominee to a *directorship* that are proposed by stockholder resolutions vary considerably. Usually, such proposals in advisory form (*i.e.*, in the form of a recommendation or a request) or as amendments to specific by-laws of the company are proper for action by security holders. Such proposals include requiring that nominees for a *directorship* be outstanding businessmen with a proven record of achievement¹⁹⁹ or own so much stock of the company²⁰⁰ or meet a certain age minimum.²⁰¹

192 DIV. LET., October 4, 1955.

193 COM. MINUTES, February 18 and 24, 1958.

194 COM. MIN., April 2, 1956.

195 AA, COM. MINUTES, March 31 and April 4, 1955.

196 DIV. LET., February, 1959; see *supra* note 65, and corresponding text.

197 COM. MIN., April 27, 1960.

198 DIV. LETTERS, September 2, 1959, and January 5, 1960.

199 CC, COM. MIN., February 19, 1962.

200 COM. MIN., July 30, 1954.

201 COM. MIN., March 7, 1961, and DIV. LET., March 12, 1962.

b. *Nominations*

Generally, resolutions, whether advisory or mandatory, proposing that a particular person be elected to fill a vacancy or an added position on the board of directors have been properly omitted,²⁰² primarily because such a proposal involves an election to office and Rule 14a-8 specifically does not apply to such.

c. *Cumulative Voting*

Where state law does not permit cumulative voting for the election of directors, resolutions proposing the same are improper for shareholder action, no matter what form the proposal takes.²⁰³

Where state law requires the articles of incorporation to provide for cumulative voting and state law also requires the board to initiate the action for amendment of the articles, a proposal *requesting* the board to take necessary steps to provide for cumulative voting is proper for a vote by security holders.²⁰⁴ Likewise, a resolution proposing the amendment of the company's by-laws to provide for cumulative voting, where state law permits such direct action by the shareholders, is proper.²⁰⁵

d. *Annual Elections*

Proposals calling for the annual election of directors, whether advisory, mandatory or in the form of an amendment to the by-laws, where necessary, are proper for action by security holders.²⁰⁶

e. *Number of Directors*

Generally, resolutions proposing an increase in the number of directors are proper subjects for action by security holders, if in the proper form. Where state law requires that by-laws fix the number of directors and the by-laws must be amended by action of the board of directors, a resolution requesting the board to take that action is necessary.²⁰⁷

f. *Remuneration*

Generally, the setting and limiting of salaries of *officers*, not directors, of the corporation are held to relate to the conduct of ordinary business operations of the issuer.²⁰⁸ However, where state law permits shareholders to fix officers' salaries, as well as directors' salaries, a resolution proposing such, and in the required form, is proper for action by security holders and does not relate to the conduct of the ordinary business operations.²⁰⁹

A resolution proposing a reduction in *directors'* salaries is proper for shareholder action, when in proper form.²¹⁰ But a resolution proposing a reduction

202 DIV. LET., January 31, 1958, and COM. MINUTES, February 26, 1959, and February 16, 1961.

203 COM. MIN., July 30, 1954.

204 COM. MINUTES, February 24 and 27, 1961.

205 COM. MIN., March 30, 1959.

206 DIV. LETTERS, March 2 and 3, 1961, and COM. MIN., February 13, 1962.

207 BB, COM. MIN., March 2, 1954.

208 DIV. LET., February 21, 1958.

209 DIV. LET., April 25, 1955.

210 E.g., COM. MINUTES, February 22, 1959, and March 15 and 21, 1960; NN, DIV. LET., March 27, 1959; DIV. LET., February 29, 1960, and COM. MIN., March 8, 1961; and DIV. LET., August 16, 1960.

in executives' salaries is usually held to relate to the conduct of ordinary business operations.²¹¹ However, such a view *may* not hold if the applicable state law permits shareholder action in this area²¹² or if the proposal, although referring to executives' salaries, would apply to only two directors.²¹³

6. *Activities of the Board of Directors*

There are a few proposals submitted to management by stockholders advising or directing that something be done or made known about the everyday activities of the board of directors itself. Because of the dearth of proposals in this area, no significant trends have been evidenced.

7. *Running of the Business in All its Operational Phases*

No major subject matter of stockholder proposals is more closely aligned to the common concept of ordinary business operations than this; many of the subjects are found to relate to ordinary business operations within the meaning of Rule 14a-8(c)(5).

a. *Wages*

Most listed companies have some form of stock option and pension plans for their employees and officers. A number of proposals are submitted each year to these companies requesting amendment of such plans, the termination of them, the setting up of new plans, changes in the application of the plans, or certain restrictions on any plans adopted in the future.

Pension plans have been held, generally, to concern the wages of the employees of the company, and, therefore, the ordinary business operations of the company.²¹⁴

Resolutions can relate to stock option plans for directors, officers and employees, the propriety of the proposal depending upon which group is beneficiary. Generally, resolutions proposing conditions for a future stock plan for directors and officers are proper for action by security holders.²¹⁵ But resolutions proposing that a stock option plan *presently in effect* be amended to impose certain new conditions are improper either because such terms would violate binding contracts between the company and the optionees²¹⁶ or relate to the conduct of the ordinary business operations since the terms proposed relate to wage payment activities.²¹⁷

Resolutions submitting by-laws or certificate amendments prohibiting the issuance of incentive options to officers and directors *without stockholder approval*²¹⁸ and forbidding the issuing of stock options unless issued *to all stockholders of the corporation*²¹⁹ have been held proper for action by security holders.

211 COM. MIN., February 22, 1959.

212 DIV. LET., August 16, 1960.

213 COM. MINUTES, March 15 and 21, 1960.

214 E.g., DIV. LETTERS, February 14, 1955, February 24, 1956, February 13, 1958, and March 4, 1959; COM. MIN., January 13, 1954; and DIV. LETTERS, March 2 and 3, 1961.

215 DIV. LET., January 6, 1958.

216 DIV. LET., December 5, 1956.

217 COM. MIN., March 13, 1959.

218 COM. MIN., March 3, 1961.

219 DIV. LET., February 17, 1960.

b. *Hiring Policies*

Proposals concerned with the qualifications of employees have been held to relate to ordinary business operations,²²⁰ as have those proposing the dismissal or the *investigation* of the issuer's lawyers.²²¹

c. *Products*

Proposals relating to the size or speed of a company's products have been held to relate to the ordinary business operations of the issuer.²²²

d. *Outsider Relations*

Some proposals for improving the relationship between the company and its stockholders relate to ordinary business operations. These proposals include requests that the board extend to stockholders the same privilege of purchasing the company's products that is accorded employees, officers and directors.²²³

Generally, proposals respecting sales to and relations with customers are held to relate to the ordinary business operations.²²⁴

e. *Litigation*

A proposal consenting to a derivative action against the president and chairman of the board of the issuer is a proper subject for action by security holders under some state laws which require that the majority of stockholders assent to such action.²²⁵ A resolution proposing a suit against another company, its management and certain officers of the issuer for violation of the antitrust laws is also proper.²²⁶

f. *Improving the Business*

A proposal *demanding* that, if a certain service performed by the company does not pay, certain alternate action should be taken, relates to ordinary business operations,²²⁷ as does a detailed proposal advising and directing the management as to the means to be used to improve the relationship between the issuer and a controlling parent.²²⁸

220 DIV. LET., January 31, 1956.

221 COM. MIN., February 29, 1960; see *supra* notes 131-32, and corresponding text.

222 E.g., DIV. LETTERS, March 22, 1955, March 19, 1958, and March 23, 1959, and COM. MIN., February 20, 1964; COM. MIN., March 4, 1964.

223 DIV. LET., April 15, 1959.

224 DIV. LETTERS, March 23, 1960, and March 14, 1961.

225 E.g., COM. MIN., January 6, 1959. But see DIV. MEMO. of February 7, 1964, and proxy material of this same company.

226 COM. MINUTES, March 4 and 5, 1958.

227 DIV. LET., March 3, 1959, and COM. MIN., April 1, 1960.

228 DIV. LET., April 14, 1959.

APPENDIX

Rule 14a-8 (a) If any security holder entitled to vote at a meeting of security holders of the issuer shall submit to the management of the issuer a reasonable time before the solicitation is made a proposal which is accompanied by notice of his intention to present the proposal for action at the meeting, the management shall set forth the proposal in its proxy statement and shall identify the proposal in its form of proxy and provide means by which security holders can make the specification provided for by Rule 14a-4(b). A proposal so submitted with respect to an annual meeting more than 60 days in advance of a day corresponding to the first date on which management proxy soliciting material was released to security holders in connection with the last annual meeting of security holders shall prima facie be deemed to have been submitted a reasonable time before the solicitation. This rule shall not apply, however, to elections to office.

These suggestions are made in the hope that they will be taken by the staff of the Division of Corporation Finance and the Commission itself as a *challenge* which, if accepted with all its ramifications, can improve the SEC's administration of this most informal decision-making process and keep Rule 14a-8 in all its complexity from becoming oppressive to the small individual stockholder. Indeed, if accepted in the spirit intended, this challenge can make the *second decade* since the amendment of the stockholder proposal rule a real period of shareholder democracy.

(b) If the management opposes the proposal, it shall also, at the request of the security holder, include in its proxy statement the name and address of the security holder and a statement of the security holder in not more than one hundred words in support of the proposal. The statement and request of the security holder shall be furnished to the management at the same time that the proposal is furnished. Neither the management nor the issuer shall be responsible for such statement.

(c) Notwithstanding the foregoing, the management may omit a proposal and any statement in support thereof from its proxy statement and form of proxy under any of the following circumstances:

(1) If the Proposal as submitted is, under the laws of the issuer's domicile, not a proper subject for action by security holders; or

(2) If it clearly appears that the proposal is submitted by the security holder primarily for the purpose of enforcing a personal claim or redressing a personal grievance against the issuer or its management, or primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes; or

(3) If the management has at the security holder's request included a proposal in its proxy statement and form of proxy relating to either of the last two annual meetings of security holders or any special meeting held subsequent to the earlier of such two annual meetings and such security holder has failed without good cause to present the proposal, in person or by proxy, for action at the meeting; or

(4) If substantially the same proposal has previously been submitted to security holders, in the management's proxy statement and form of proxy relating to any annual or special meeting of security holders held within the preceding five calendar years, it may be omitted from the management's proxy material relating to any meeting of security holders held within the three calendar years after the latest such previous submission, provided that —

- (i) If the proposal was submitted at only one meeting during such preceding period, it received less than 3% of the total number of votes cast in regard thereto; or
- (ii) if the proposal was submitted at only two meetings during such preceding period it received at the time of its second submission less than 6% of the total number of votes cast in regard thereto; or
- (iii) if the proposal was submitted at three or more meetings during such preceding period, it received at the time of its latest submission less than 10% of the total number of votes cast in regard thereto.

(5) If the proposal consists of a recommendation or request that the management take action with respect to a matter relating to the conduct of the ordinary business operations of the issuer.

(d) Whenever the management asserts that a proposal and any statement in support thereof may properly be omitted from its proxy statement and form of proxy, it shall file with the Commission, not later than 20 days prior to the date the preliminary copies of the proxy statement and form of proxy are filed pursuant to Rule 14a-6(a), or such shorter period prior to such date as the Commission may permit, a copy of the proposal and any statement in support thereof as received from the security holder, together with a statement of the reasons why the management deems such omission to be proper in the particular case, and, where such reasons are based on matters of law, a supporting opinion of counsel. The management shall at the same time, if it has not already done so, notify the security holder submitting the proposal of its intention to omit the proposal from its proxy statement and form of proxy and shall forward to him a copy of the statement of the reasons why the management deems the omission of the proposal to be proper and a copy of such supporting opinion of counsel.